

STATE OF MINNESOTA  
OFFICE OF ADMINISTRATIVE HEARINGS  
FOR THE  
MINNESOTA PUBLIC UTILITIES COMMISSION

In the Matter of the Application of  
CenterPoint Energy Minnesota Gas, a  
Division of CenterPoint Energy Resources  
Corp., for Authority to Increase Natural Gas  
Rates in Minnesota

**FINDINGS OF FACT,  
CONCLUSIONS, AND  
RECOMMENDED ORDER**

This matter came on for evidentiary hearing before Administrative Law Judge Beverly Jones Heydinger on April 11, 2006 in the Large Hearing Room at the offices of the Public Utilities Commission ("Commission") in St. Paul, Minnesota. The evidentiary hearing continued until April 13, 2006. Public hearings were held by videoconference on March 29, 2006, between St. Paul, Brainerd, Plymouth, North Mankato, and Willmar. Additional public hearings were held in Minneapolis at the Minneapolis Community and Technical College on March 28, 2006; in Coon Rapids on March 30, 2006; in Bloomington on April 5, 2006; and in Minneapolis at the Sabathani Community Center on April 11, 2006.

After the conclusion of the evidentiary hearing, the Commission determined that additional hearings were appropriate regarding the proposed affordability program and the background on CenterPoint's billing system. Additional hearings were scheduled for June 8 and June 28, 2006. Following further discovery, the parties agreed that the June 8 hearing was not necessary and it was cancelled. The hearing on the billing program was held on June 28, 2006.

A briefing schedule was established at the conclusion of the evidentiary hearings. Posthearing briefs were filed on July 11, 2006; supplemental briefs were filed on August 4, 2006; and reply briefs were filed on August 14, 2006. The hearing record closed on August 14, 2006.

Eric Swanson and David Aafedt, Attorneys at Law, Winthrop & Weinstine, 225 South Sixth Street, Minneapolis, MN 55402, appeared for CenterPoint Energy Resources Corp. (CenterPoint or the Company).

Karen Finstad Hammel and Valerie Smith, Assistant Attorneys General, 1400 Bremer Tower, 445 Minnesota Street, St. Paul, Minnesota 55101, appeared for the Minnesota Department of Commerce (Department).

Ron Giteck and Steve Alpert, Assistant Attorneys General, 900 Bremer Tower, Suite 900, 445 Minnesota Street, St. Paul, Minnesota 55101, appeared for the Minnesota Office of the Attorney General-Residential Utilities Division (OAG-RUD).

Chris Duffrin, Assistant Director, and Pam Marshall, Executive Director of the Energy CENTS Coalition (Energy CENTS), 823 East 7<sup>th</sup> Street, Saint Paul, Minnesota 55106, appeared on behalf of Energy CENTS.

James Strommen, Attorney at Law, Kennedy & Graven, 200 South Sixth Street, Suite 470, Minneapolis, Minnesota 55402, appeared for the Suburban Rate Authority (SRA).

Robert Harding, Rates Analyst; Jerry Dasinger, Financial Analyst; and Stuart Mitchell, Rates Analyst, 121 Seventh Place East, Suite 350, St. Paul, Minnesota 55101, appeared on behalf of the Staff of the Minnesota Public Utilities Commission (Commission).

### **NOTICE**

Notice is hereby given that, pursuant to Minn. Stat. § 14.61, and the Rules of Practice of the Minnesota Public Utilities Commission ("Commission") and the Office of Administrative Hearings, exceptions to this Report, if any, by any party adversely affected must be filed according to the schedule which the Commission will announce. Exceptions must be specific and stated and numbered separately. Proposed Findings of Fact, Conclusions and Order should be included, and copies thereof shall be served upon all parties. Oral argument before a majority of the Commission will be permitted to all parties adversely affected by the Administrative Law Judge's recommendation who request such argument. Such request must accompany the filed exceptions or reply (if any), and an original and 15 copies of each document should be filed with the Commission.

The Commission will make the final determination of the matter after the expiration of the period for filing exceptions as set forth above, or after oral argument, if such is requested and had in the matter.

Further notice is hereby given that the Commission may, at its own discretion, accept or reject the Administrative Law Judge's recommendation and that said recommendation has no legal effect unless expressly adopted by the Commission as its final order.

Under Minn. Stat. § 216B.16, subd. 1a, if the Commission rejects or modifies the Settlement between the Energy CENTS and the Company, this matter may be extended by 60 days for conclusion of this proceeding.

### **STATEMENT OF ISSUES**

CenterPoint has requested an increase in its natural gas rates of \$40.9 million, which is approximately a 2.4% increase in annual revenues. The Commission has

directed that an evidentiary record be established on that request with regard to the following issues:

- Is the revenue increase sought by CenterPoint reasonable or will it provide CenterPoint with unreasonable or excessive earnings?
- Is the rate design proposed by CenterPoint – including the proposed residential customer charge and “block rates” – reasonable? CenterPoint proposes to increase the proportion of its revenues that it collects through a fixed monthly charge and decrease the proportion that it collects for each unit of gas sold. In addition, CenterPoint no longer proposes to charge a uniform rate per therm of gas it provides to residential customers; instead, it proposes to charge varying prices depending on the volume of gas the customer consumes.
- Are CenterPoint’s proposed capital structure and return on capital reasonable? Generally a utility can acquire capital more cheaply by borrowing than by selling equity, but debt payments restrict a utility’s finances more than equity does, so a balance needs to be struck in the public interest. The Commission must provide an opportunity for utilities to earn sufficient revenues to pay an adequate return on capital, but not an excessive return.
- Is it reasonable for CenterPoint to model normal weather on the basis of ten years of data rather than twenty? The past ten years have been warmer on average than the ten years prior. All else being equal, a gas utility will sell less gas in warmer weather, and therefore would need to recover a larger share of its operating costs for each unit of gas sold.
- Should the Commission approve CenterPoint’s proposed residential affordability program? CenterPoint favors creating a program to subsidize service to low-income customers, but many details remain unspecified.
- Should the Commission authorize CenterPoint to recover uncollected gas costs through the Purchased Gas Adjustment (PGA) pursuant to Minnesota Rules parts 7825.2390 – 7825.2920? An energy utility’s bill reflects both a base rate and various automatic adjustments to that base rate such as the PGA. The base rate reflects a utility’s prudently-incurred costs, including the cost of revenues lost when a customer cannot pay its bill. The PGA permits gas utilities to adjust their rates periodically to reflect fluctuations in the cost of natural gas. CenterPoint now proposes to recover the fuel-related portion of bad debt costs through the PGA rather than through base rates.<sup>1</sup>

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<sup>1</sup> *In the Matter of the Application of CenterPoint Energy Minnesota Gas, a Division of CenterPoint Energy Resources Corp. for Authority to Increase Natural Gas Rates in Minnesota*, PUC Docket No.

- Was CenterPoint prudent regarding its investment in and implementation of its new billing system and related calling issues.<sup>2</sup>

Based on all the proceedings herein, the Administrative Law Judge makes the following:

## FINDINGS OF FACT

### **A. Description of the Company**

1. In 1997, the Commission approved a merger between the NorAm Energy Corporation (NorAm) and Houston Industries, Inc. (HI). CenterPoint Energy was then a division of NorAm. HI changed its name to Reliant Energy, Inc. in 1999. After a restructuring to spin off unregulated businesses in 2002, the regulated businesses began operating under the name of CenterPoint Energy, Inc. (CNP). CenterPoint Energy Resources Corporation (CPRC) is a wholly-owned subsidiary of CNP.<sup>3</sup>

2. CenterPoint operates the natural gas utility service known as CenterPoint Energy Minnesota Gas in Minnesota as a division of CPRC.<sup>4</sup> The parent corporation's headquarters are located in Houston, Texas. In addition to Minnesota, the parent corporation provides natural gas distribution services to approximately five million customers in Arkansas, Louisiana, Mississippi, Oklahoma, and Texas.<sup>5</sup>

3. CenterPoint distributes natural gas to over 750,000 customers in Minnesota. The Company added 17,000 residential customers in 2004. The Company's natural gas service territory encompasses a large part of central and southern Minnesota, including Minneapolis and its northern, southern and western suburbs. CenterPoint also operates an unregulated energy services business, Home Service Plus®, which offers repair and maintenance for a variety of heating, ventilation,

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G-008/GR-05-1380, at 4-5 (Notice and Order for Hearing issued December 21, 2005) (generally "**2005 CenterPoint Rate Matter**").

<sup>2</sup> **2005 CenterPoint Rate Matter**, (Order Referring Prudence Issues Regarding Billing System Investment and Implementation to Administrative Law Judge for Discovery and Hearing issued May 17, 2006).

<sup>3</sup> Ex. 12, Hammond Direct, at 2-3.

<sup>4</sup> Ex. 12, Hammond Direct, at 1-3. CenterPoint issues no publicly traded stock, since it is a division of CPRC. Ex. 80, Griffing Direct, at 8. Effective December 1, 2004, CPRC directed that its division formerly known as CenterPoint Energy Minnegasco would be known only as CenterPoint Energy.

<sup>5</sup> Ex. 1, Binder 1, Tab G. The total number of customers is essentially unchanged from that in CenterPoint's last rate proceeding. **ITMO the Petition of CenterPoint Energy Minnegasco, a Division of CenterPoint Resources Corp., for Authority to Increase Its Natural Gas Rates in Minnesota**, Finding 6, OAH Docket No. 7-2500-16151-2, PUC Docket No. G-008/GR-04-901 (ALJ Findings of Fact, Conclusion, and Recommendation issued March 25, 2005)(**2004 CenterPoint Rate Matter**).

and air conditioning (HVAC) and other appliances.<sup>6</sup> The Company's last rate increase in Minnesota was \$9 million (approximately 0.75% of revenues), granted in 2005.<sup>7</sup>

## **B. Jurisdictional-Procedural Background**

4. On November 2, 2005, CenterPoint filed a Petition with the Commission, under Minn. Stat. § 216B.16, for an increase in natural gas rates of \$40,878,000 (over all, approximately a 2.4 percent increase over the test year (current rates)). CenterPoint also made a request for Interim Rates in the amount of \$34,719,000 (a 2.07 percent increase).<sup>8</sup>

5. On December 21, 2005, the Commission issued an Order accepting the filing as complete as of November 2, 2005, and suspending the proposed rate increase until the Commission determines the reasonableness of the proposed rates.<sup>9</sup> Also on that date the Commission issued a Notice and Order for Hearing, directing that a contested case hearing be convened to determine the reasonableness of the rate changes proposed by CenterPoint.<sup>10</sup>

6. On December 21, 2005, the Commission issued an Order approving the proposed interim rates. The interim rates became effective on January 1, 2005. CenterPoint is collecting interim rates subject to refund if the interim rates are in excess of the final rates determined by the Commission.<sup>11</sup>

7. On January 13, 2006, a prehearing conference was held before Administrative Law Judge Beverly Jones Heydinger in St. Paul, Minnesota. The parties to the proceeding at that time were CenterPoint, the Department, and OAG-RUD. Petitions to Intervene were pending for SRA, Cornerstone Energy (as a participant), and Energy CENTS, and those petitions were granted by the ALJ. Subsequently, Legal Services Advocacy Project (LSAP) petitioned to intervene and was added as a party.

8. On May 1, 2006, CenterPoint submitted a Motion For Extension of the deadline for the Commission to take final action on its rate increase request. The Commission considered the motion on May 11, 2006. At that hearing, CenterPoint offered to waive its statutory right under Minn. Stat. § 216B.16, subd. 2, to place its proposed final rates into effect following the expiration of the statutory deadline for deciding rate increase petitions. The waiver period proposed was one month. This

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<sup>6</sup> Ex. 1, Binder 1, Tab G.

<sup>7</sup> **2004 CenterPoint Rate Matter**, (Commission Order Accepting and Modifying Settlement and Requiring Compliance Filing issued June 8, 2005)(“2005 Commission Order”). Prior to the 2005 Commission Order, the most recent rate increase for CenterPoint, occurred in 1996. **ITMO the Application of Minnegasco, a Division of NorAm Energy Corp., for Authority to Increase Its Natural Gas Rates in Minnesota**, PUC Docket No. G-008/GR-95-700 (Findings of Fact, Conclusions of Law, and Order issued June 10, 1996)(“**1996 CenterPoint Rate Matter**”).

<sup>8</sup> Ex. 1, Binder 1, Notice of Change in Rates.

<sup>9</sup> **2005 CenterPoint Rate Matter**, (Order Accepting Filing and Suspending Rates issued December 21, 2005).

<sup>10</sup> *Id.* (Notice and Order for Hearing issued December 21, 2005).

<sup>11</sup> *Id.* (Order Setting Interim Rates issued December 21, 2005).

period was in addition to the month-long extension relating to a stipulation regarding a proposed Affordability Program.

9. On May 17, 2006, the Commission issued an Order Referring Prudence Issues Regarding Billing System Investment and Implementation To Administrative Law Judge For Discovery and Hearing. The Commission also extended the deadline for a Commission decision in this matter to November 2, 2006, and referred this matter back to the ALJ for additional discovery and hearing on the issues of the prudence of the investment in and the implementation of the new billing system and related calling issues.<sup>12</sup>

10. On June 28, 2006, the evidentiary hearing reconvened to address the remaining issues relating to the Affordability Program and the billing system. At the hearing, a briefing schedule was established, with posthearing briefs due on July 11, 2006 and reply briefs due August 14, 2006. The hearing record closed in this matter on August 14, 2006.

### **C. Natural Gas Service Areas**

11. CenterPoint's natural gas customers are divided between two service areas, denominated the Northern Service Area and the Viking Service Area. CenterPoint has been moving toward consolidating the rate structures of these two areas that have previously been modestly different. The Northern Service Area includes the City of Minneapolis. The Viking Service Area covers portions of the state away from the metropolitan area. CenterPoint has proposed to move to one rate structure as part of this proceeding.<sup>13</sup>

### **D. Summary of Public Comments**

12. Public comments on CenterPoint's proposed rate increase were received from attendees at the five public hearings, including one video conference, and persons who mailed (or emailed) their written comments. All of those comments have been read and this summary is provided as a representative sampling of those comments.

13. At the public hearings, CenterPoint Energy was represented by Rolf Lund, Public Relations Officer, or Patty Pedersen, Associate Director of Public Relations. They testified in a consistent manner at all hearings. A rate case "fact sheet" was distributed to assist the public in understanding CenterPoint's proposed rate increase. The proposed rate increase for natural gas distribution by CenterPoint Energy would increase revenues by \$40.9 million annually, which is 2.4 percent of the company's total annual revenue. Because this increase only affects the costs of providing distribution, only 20 percent of a typical customer's bill is affected.<sup>14</sup>

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<sup>12</sup> **2005 CenterPoint Rate Matter**, (Order Referring Prudence Issues Regarding Billing System Investment and Implementation to Administrative Law Judge for Discovery and Hearing issued May 17, 2006).

<sup>13</sup> Ex. 12, Hammond Direct, at 22.

<sup>14</sup> Minneapolis Public Hearing Tr. (April 11, 2006), at 10.

14. The rate increase is needed, CenterPoint contends, to recover the costs of its growing distribution system. Increases in the cost of bad debt and in the cost of storing purchased natural gas, both linked to rising gas costs, were cited by CenterPoint as adding to the need for a rate increase. Street and highway projects have required CenterPoint to move gas lines, thereby increasing capital costs. The Midwest Gas replacement project was also identified as increasing costs by \$7 million, adding to CenterPoint's revenue shortfall. CenterPoint undertook this project following a gas explosion and investigation by the Office of Pipeline Safety to replace gas lines that could contain a defective coupling. CenterPoint also noted that the per customer use of natural gas was decreasing, causing a reduction in revenue, without a corresponding reduction in fixed costs. The revenue impact of declining natural gas usage was estimated to be about \$7 million.<sup>15</sup>

15. CenterPoint estimated that the impact of the proposed rate increase on the average residential customer would be approximately \$3 per month, half tied to the proposed increase in the residential basic customer charge, from the current level of \$6.50 to the proposed \$8.00. CenterPoint suggested that the additional revenue from the increase in the fixed charge would benefit the company by rendering its revenues less dependent on seasonal fluctuations and, thus more consistent throughout the year. The proposal for introducing block rates was mentioned, and CenterPoint asserted that this approach would encourage conservation.<sup>16</sup>

16. At the public hearings, the Office of the Attorney General (OAG) was represented by Ron Giteck and Mary McKinley, Assistant Attorneys General in the Residential and Small Business Utilities Division; Jessica Palmer-Denig, Manager of the Residential and Small Utilities Division; Colleen Crossley, Consumer Liaison; Amy Brendmoen, Investigator; and Curtis Nelson, a Financial Analyst. Specifically, the OAG expressed concern that, under CenterPoint's proposal, business customer rates would decrease at the expense of residential customer rates. Further, the new rate design will likely increase rates paid by residential customers in a greater proportion than business customers. Including the increase in the residential basic charge from the prior year's rate adjustment, the change from \$5 to \$8 amounts to a 60 percent rate increase for residential customers in that single charge. The OAG also noted that the impact of the block rate proposal amounts to an additional residential basic charge of \$1.62, because almost all residential customers will use the first block of therms every month. The impact of bad debt on CenterPoint's rate increase request was raised as a concern. OAG disputed whether CenterPoint's explanation of declining use was accurate. The proposed cost of the Midwest Gas replacement project and the manner in which customer billing system changes were accomplished were also of concern to the OAG.<sup>17</sup>

17. At the public hearings, the Department of Commerce (Department) was represented by Karen Finstad Hammel and Valerie Smith, Assistant Attorneys General,

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<sup>15</sup> Minneapolis Public Hearing Tr. (April 11, 2006), at 11-13.

<sup>16</sup> Minneapolis Public Hearing Tr. (April 11, 2006), at 14-15.

<sup>17</sup> Minneapolis Public Hearing Tr. (April 11, 2006), at 18-22.

and Analysts Michelle St. Pierre, Sundra Bender, Jason Bonnett, Vince Chavez, Bryan Minder, and Dr. Marlon Griffing. The testimony from the Department representatives was consistent throughout the public hearings. In essence, the Department's presentation at the public hearings was that it represents the interests of all ratepayers in utility proceedings before the Commission. The Department noted that its review of costs and revenue resulted in a proposed reduction of CenterPoint's requested rate increase to \$27 million. The Department also noted its agreement with CenterPoint's proposal to raise the residential basic charge to \$8.00.<sup>18</sup>

18. The Energy CENTS Coalition (Energy CENTS) was represented by Chris Duffrin. Energy CENTS is a statewide coalition of organizations that promote more affordable energy service for low-income and fixed-income Minnesotans through advocacy efforts, regulatory proceedings, and policy and program development. The agreement between CenterPoint and Energy CENTS on a \$5 million energy affordability program and the effect of that agreement on bad debt recovery was described. Remaining concerns expressed by Energy CENTS included the impact of the proposed residential basic charge increase and the modified block rate increase. Energy CENTS also questioned why customers should be paying for the Midwest Gas replacement project before litigation concerning responsibility for the line explosion had been resolved.<sup>19</sup>

19. Commissioner Reha was present for the evening videoconference and at the hearing in Bloomington. Commissioner Nickolai was present at the afternoon hearing in Minneapolis.

20. Michele H. Kimball, State Director, and Hubert H. (Skip) Humphrey, III, State President of the Minnesota chapter of the American Association of Retired Persons (AARP) noted that CenterPoint's proposed rate increases in both the basic charge and the delivery charge would result in average monthly increases of \$3 (for Northern customers) and \$5 (for Viking customers). These increases, ranging from 3.3% to 5.7% for residential customers, were contrasted with the overall revenue increase of 2.4%. AARP urged the adoption of rates that ensured residential customers paid only their fair share of any revenue increase.

21. AARP objected to the increase in the residential basic charge from \$6.50 to \$8.00. Although AARP acknowledges that utilities favor higher basic charges to stabilize their cash flow, AARP maintains that high basic charges are "bad public policy." Lowry Johnson, President of the Sabathani AARP chapter, urged the commission to keep the interests of residential customers in mind when deciding on CenterPoint's proposed rate increase. Particularly for older Americans, AARP maintained that utility services overall can account for as much as 23% of a household's monthly income. The proposed residential basic charge increase to \$8.00 was opposed as merely favoring CenterPoint's private interest.<sup>20</sup>

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<sup>18</sup> Minneapolis Public Hearing Tr. (April 11, 2006), at 18-22.

<sup>19</sup> Minneapolis Public Hearing Tr. (April 11, 2006), at 27-30.

<sup>20</sup> Minneapolis Public Hearing Tr. (April 11, 2006), at 32-34.



22. AARP also objected to the change from a single delivery rate to the modified inverted block rate approach proposed by CenterPoint. This change will, AARP asserts, discourage conservation and penalize low-income and low-usage customers. AARP also objected to automatic adjustments for bad debt expenses. AARP suggested that CenterPoint offer debt collection alternatives and increase enrollment in low-income energy assistance programs to address the bad debt problem.

23. Regarding the overall economic burden imposed by energy costs, AARP recommended adoption of a low-income energy assistance program that would limit the percentage of household income that must be devoted to energy costs. An arrearage forgiveness component was also recommended.

24. Many members of the public were concerned about the recent steep increases in their utility bills. Although some of them acknowledged that much of the increase was tied to the rise in the cost of natural gas, the overall impact on customers has the effect of making it more difficult to pay their gas bill. Low income and fixed income customers, in particular, have trouble finding the money to pay their utility bill and keep up with other rising costs such as health care and local taxes. Charles Long of Minneapolis, Minnesota described the impact of increasing gas costs on customers with fixed incomes. He noted that while his consumption of gas had decreased over the last year by 65 therms, but his gas bill had increased by \$78.00.<sup>21</sup> Lucy Harlan of Plymouth, Minnesota expressed concern over “run-away pricing” and noted that her gas charges tripled between November and December 2005.

25. Elizabeth and Joseph Bush of Columbia Heights, Minnesota, objected to the increase in the basic monthly charge and the high delivery charge for the first unit of therms under the block rate approach. The Bushes suggested that a low basic charge and low delivery rate for the first tier of therms would provide greater incentives for conservation. They also suggested increasing the low-cost tier to a larger number of therms in the winter months. They believe that these changes would protect the poorest and lowest-usage customers from large increases in unavoidable energy costs. Judy Hanson of Lake Crystal, Minnesota, noted that in addition to the proposed increases in the basic charge and the delivery rate, Lake Crystal residents who are CenterPoint customers also pay a monthly franchise fee of \$9.72 to receive natural gas. The effect of these charges on low-income consumers is to require exceptional conservation measures. This commentator suggested that CenterPoint has not provided additional services to justify the proposed increases.

26. Doctor Christine Ziebold, a physician specializing in children’s environmental health, expressed concern that CenterPoint’s proposed rate structure provides disincentives for switching to renewable energy. She described that rate structure as “globally unsustainable and irresponsible business.”<sup>22</sup>

27. Donald Hinrichs of Osakis, Minnesota, noted that the proposed rate increases ranged from 3.3% for the residential customer class to 1.9% for larger

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<sup>21</sup> Minneapolis Public Hearing Tr. (March 28, 2006), at 27-34.

<sup>22</sup> Minneapolis Public Hearing Tr. (April 11, 2006), at 41-48.

customers. He objected to this approach, saying that “the big guys get the breaks at the little guys’ expense.” Mr. Hinrichs urged that all customer classes be treated the same with respect to any increase in rates. Other members of the public questioned whether the proposed rates would benefit large volume customers over smaller residential customers. Rod Quist of Maple Lake, Minnesota, recommended that CenterPoint’s rate increase be distributed evenly across the Residential and Business customer classes. Mr. Quist noted that businesses were able to pass on the cost of the increases to consumers.

28. James Meiners of Minneapolis, Minnesota, described the impact of CenterPoint’s proposed rate structure would have on low-usage consumers of natural gas like him who use less than 18 therms per month. For these customers, the percentage increase is far higher than that indicated by CenterPoint for the Residential customer class. This was echoed by others, including Mae Singer and Mary Magnuson of Coon Rapids, Minnesota.

29. Ms. Harlan, Jan Steuve of Rockville, Minnesota, and others also questioned the proposed reimbursement to CenterPoint for the expense of the Midwest Gas line replacement. They were concerned about whether CenterPoint was insured against the Anoka area explosions and, if so, whether including the costs of replacement in the rate would give CenterPoint a double recovery. Some members of the public, including Elaine Fleskes of Annandale, Minnesota, also maintained that the replacement of the Midwest Gas lines is a risk properly borne by the Company’s shareholders, not ratepayers. These commenters and other members of the public generally agreed with the OAG that no costs for the service line replacement should be included in the rates until the litigation over the responsibility for the line explosion has been resolved.

30. Several members of the public objected to CenterPoint’s contention that increased energy efficiency and conservation had led to declining usage, which in turn would require an increase in rates to meet CenterPoint’s fixed costs. One commenter questioned why the increase in customers would not help to offset some of the decreased revenue from lower customer usage. Others questioned why additional conservation was not encouraged rather than discouraged through the requested increase.

31. Elaine Fleskes of Annandale, Minnesota and Thomas Stolareck of Minneapolis, Minnesota, were among those who objected to CenterPoint’s citing of reduced energy use due to energy efficiency as a reason for increasing rates. Ms. Fleskes felt that this approach “punished” consumers for being energy efficient. Mr. Stolareck described allowing rate increases as a response to conservation as “unjust.”

32. One commenter, Jim Million of Fridley, Minnesota asserted that CenterPoint was essentially using “futures contracts” to shift the risk of changes in natural gas pricing to consumers, and that CenterPoint has not supported its assertions regarding capital budget expenditures.

33. Mike Banks, a Councilmember from St. James, Minnesota, questioned why CenterPoint was adding so many residential and electrical generating customers if natural gas was in such short supply.

34. One commenter disputed CenterPoint's assertions regarding return on equity. One maintained that CenterPoint should produce more revenue from its unregulated services.

35. Some members of the public simply objected to the increase because CenterPoint had received an increase so recently, and CenterPoint's reasons for the increase were unsupported. One complained that executive compensation was excessive and contributed to the rate increase.<sup>23</sup> Others complained about the difficulty understanding either the bills that they received or the options that might be available for paying the increased bills.

36. Additional comments addressed the extra burden that low-income customers bear when rates are increased. Shada Buyobe-Hammond, Chair of the Minnesota Association of Community Organizations for Reform Now (ACORN), strongly objected to CenterPoint's proposed rate increase. ACORN's concerns included the effect of additional increases on customers already on repayment plans, the distribution of the burden between commercial and residential classes, and a perceived lack of outreach to low-income communities.<sup>24</sup> Victor Smith, President of Men Against Destruction, Defending Against Drugs and Social Disorder (MAD DADS), also objected. MAD DADS maintained that high gas costs contributed to a host of problems faced by low-income customers. Mr. Smith also suggested that the public would get better notice of the rate hearings if notice was included in the local community papers and through radio.<sup>25</sup>

37. Several persons objected to CenterPoint receiving a rate increase to cover increased bad debt. In their view, this further "punishes" customers who pay their bills, many of whom may sacrifice other necessary goods and services to do so.<sup>26</sup> John Doll of Burnsville, Minnesota maintained that raising rates would exacerbate the bad debt problem cited by CenterPoint as a reason for raising rates. Mr. Doll also urged CenterPoint to negotiate strongly with suppliers to ensure the lowest wholesale price of gas.<sup>27</sup>

## **E. CenterPoint Capital Structure**

38. CenterPoint lacks a readily defined capital structure, due to its status as a wholly-owned subsidiary. Under such circumstances, Commission practice has been to substitute a hypothetical capital structure that is then used to assess the proposed

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<sup>23</sup> Bloomington Public Hearing Tr. (April 5, 2006), at 23-27.

<sup>24</sup> Minneapolis Public Hearing Tr. (April 11, 2006), at 54-59.

<sup>25</sup> Minneapolis Public Hearing Tr. (April 11, 2006), at 64-73.

<sup>26</sup> See e.g., Coon Rapids Public Hearing Tr. (March 30, 2006), at 27-34.

<sup>27</sup> Bloomington Public Hearing Tr. (April 5, 2006), at 27-34.

rates.<sup>28</sup> For the purposes of the **2004 Rate Matter**, CenterPoint proposed and the parties agreed to the following capital structure:<sup>29</sup>

#### **2004 CenterPoint Capital Structure**

Long-Term Debt	46.17%
Short-Term Debt	3.56%
Common Stock Equity	50.27%

The Commission accepted the capital structure as part of the settlement in that matter.

39. CenterPoint proposed that the following capital structure be used to determine the revenue requirements in this proceeding:<sup>30</sup>

#### **2006 CenterPoint Proposed Capital Structure**

Long-Term Debt	47.27%
Short-Term Debt	2.60%
Common Stock Equity	50.13%

40. CenterPoint calculated the proposed structure from the projected debt and equity balances from the 2006 test year. The result was very similar to the previously-approved 2004 capital structure.<sup>31</sup>

41. The Department initially proposed a capital structure differing significantly from CenterPoint's proposal for long-term and short-term debt, and differing slightly in the relationship of debt to equity. These differences arose from the Department's methodology, which averaged CenterPoint's actual financial results from 2003, 2004, and 2005.<sup>32</sup>

42. With additional information obtained through this contested case proceeding, the Department reassessed its position on CenterPoint's capital structure. The Department objected to CenterPoint's proposed capital structure as unsupported. CenterPoint's updated figures for long-term debt (\$332,793,000) and common equity

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<sup>28</sup> *ITMO the Application of Minnegasco, a Division of Arkla, Inc., for Authority to Increase Its Rates for Natural Gas Service in Minnesota*, PUC Docket No. G-008/GR-93-1090, at 15-16 (Findings of Fact, Conclusions and Order issued October 24, 1994).

<sup>29</sup> **2004 CenterPoint Rate Matter**, Findings 9 and 10, (ALJ Findings of Fact, Conclusions of Law, and Recommended Order issued March 25, 2005)(“2005 ALJ Recommendation”).

<sup>30</sup> Ex. 1, Binder 1, Tab D.

<sup>31</sup> Ex. 29, Hadaway Direct, at 5.

<sup>32</sup> Ex. 80, Griffing Direct, at 34.

(\$326,222,000) were added, with the total equating to 87.78% of CenterPoint's total capital structure. The Department divided the total by the percentage and arrived at \$750,539,000, described as the total value of CenterPoint's capital structure. Subtracting the long-term debt and common equity figures from this total value results in the average amount of short-term debt (\$91,716,000) that CenterPoint will incur in the test year.<sup>33</sup>

43. With these calculations, the Department asserts that CenterPoint is being operated with a capital structure significantly different from the debt/equity ratio of 50/50 required by a recent Commission Order regarding CenterPoint's financial condition.<sup>34</sup> In that proceeding, CenterPoint undertook to: 1) maintain a capitalization structure in Minnesota typical of an A-rated utility, and 2) maintain a debt/equity ratio of 50/50. The Commission accepted those goals and required that CenterPoint adhere to that capitalization structure.<sup>35</sup> The Department asserts that the following capital structure for CenterPoint is more accurate:<sup>36</sup>

#### **Department Proposed Capital Structure for CenterPoint**

Long-Term Debt	44.31%
Short-Term Debt	12.22%
Common Stock Equity	43.47%

44. At the hearing, testimony tended to support the Department's assertion that CenterPoint's business operations did not reflect a capital structure with a 50/50 debt/equity ratio.<sup>37</sup> CenterPoint acknowledged that significant short-term debt had been accumulated and that an infusion of capital was "being considered."<sup>38</sup>

45. CenterPoint provided no contrary analysis to demonstrate that the Department was incorrect in its calculations or conclusions regarding the percentages appropriately assigned to equity, long-term debt, and short-term debt. CenterPoint's testimony on its efforts to maintain 50/50 debt/equity ratio were not supported by documentation.<sup>39</sup> CenterPoint's testimony regarding the levels of short-term debt

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<sup>33</sup> Ex. 84, Griffing Surrebuttal, at 12.

<sup>34</sup> ***ITMO an Inquiry into Possible Effects of the Financial Difficulties at Reliant Energy, Inc. on Reliant Energy Minnegasco and its Customers***, PUC Docket No. G-008/CI-02-1368 (Order Requiring Filings to Protect Minnesota Ratepayers issued April 8, 2003)("2003 Reliant Energy Minnegasco Inquiry Order").

<sup>35</sup> ***2003 Reliant Energy Minnegasco Inquiry Order***, at 10, 12.

<sup>36</sup> Ex. 84, Griffing Surrebuttal, at 12.

<sup>37</sup> See Ex. 90 (showing 13-month averages for CenterPoint's capital structure of 44.83% equity, 38.06% long-term debt, and 17.11% short-term debt). The percentages are taken from the replacement Ex. 90 that was submitted on May 5, 2006, correcting a mathematical error in the initial document.

<sup>38</sup> Hearing Tr. Vol 2, at 52-53.

<sup>39</sup> Hearing Tr. Vol 2, at 37-38 and 52-53.

tended to support the Department's position on this issue.<sup>40</sup> While CenterPoint maintained it has taken "a number of steps [to maintain its debt/equity ratio]," this record lacks the factual support needed to conclude that CenterPoint's test year structure will reflect the percentages proposed in CenterPoint's rate petition.<sup>41</sup>

46. The 50/50 debt-to-equity ratio required under the **2003 Reliant Energy Minnegasco Inquiry Order** was cited by CenterPoint as reason to approve its proposed capital structure. The Department disputed this contention, maintaining that the capital structure for setting rates should reflect the realities of how CenterPoint has conducted the financial aspects of its business.<sup>42</sup>

47. The **2003 Reliant Energy Minnegasco Inquiry Order** does not direct CenterPoint to use a 50/50 debt-to-equity ratio in rate setting. Rather, that Order directs CenterPoint to "maintain approximately a 50/50 debt equity ratio. . . ." The Order is aimed at the actual financial transactions engaged in by CenterPoint when operating its business, not a hypothetical situation arising solely in ratemaking.

48. The Department recognized that actions taken subsequent to the hearing (or taken but not supported by evidence in the record) could support a different capital structure and change CenterPoint's revenue requirement by approximately \$3 million. To accommodate that possibility, the Department proposed adopting CenterPoint's proposed capital structure of 47.27% long-term debt, 2.6% short-term debt, and 50.13% common stock equity, subject to CenterPoint's demonstration that its actions conform to that structure.<sup>43</sup>

49. CenterPoint agreed that the Department's proposal provides a reasonable means for the Commission to confirm that the hypothetical capital structure approaches the 50/50 requirement of the **2003 Reliant Energy Minnegasco Inquiry Order**. CenterPoint committed to providing a report by March 1, 2007, addressing:

- A. Whether the Company did indeed convert over \$100 million of short-term debt to long-term debt.
- B. Whether this conversion, coupled with the seasonal forces discussed by CenterPoint, have dramatically reduced the Company's short-term debt.
- C. Whether CenterPoint discontinued paying dividends to its parent company.
- D. Whether CenterPoint made equity infusions in 2006, and in what amounts.

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<sup>40</sup> Hearing Tr. Vol. 2, at 133-139.

<sup>41</sup> CenterPoint Brief, at 14.

<sup>42</sup> Hearing Tr. Vol. 3, at 198-199.

<sup>43</sup> Department Brief, at 21-22.

- E. What is the appropriate debt/equity ratio for CenterPoint in light of the foregoing actions.<sup>44</sup>

50. The Department's proposed capital structure is supported by the record in this matter. With the further showing proposed by CenterPoint, CenterPoint's alternative capital structure may be appropriate for adoption. CenterPoint bears the burden of demonstrating the appropriate capital structure to be used for calculating CenterPoint's revenue requirement. Since CenterPoint has not shown on the record in this proceeding that it has complied with the 50/50 debt/equity requirement of the **2003 Reliant Energy Minnegasco Inquiry Order**, the Administrative Law Judge recommends that the Commission adopt the Department's proposed capital structure for rate setting. In the event the Commission accepts CenterPoint's capital structure, the Administrative Law Judge recommends that the Commission require that CenterPoint file a report by March 1, 2007 report consistent with the Department's recommendation and include in the Commission's order true-up language that expressly commits CenterPoint to accepting the adjusted revenue requirement demonstrated by that report.

#### **F. Return on Equity – Rate of Return**

51. The Commission's statutory responsibility is to set rates that are just and reasonable.<sup>45</sup> The determination of reasonableness involves a balancing of consumer and utility interests. A reasonable rate enables a public utility not only to recover its operating expenses, depreciation, and taxes, but also allows it to compete for funds in capital markets. Allowing a fair and reasonable return upon the utility's investment in property to provide the utility service is a factor in setting just and reasonable rates.<sup>46</sup> Minnesota law requires that any doubt as to reasonableness must be resolved in favor of the consumer.<sup>47</sup>

52. A regulated utility's return must be reasonably sufficient to assure financial soundness and provide the utility adequate means to raise capital.<sup>48</sup> The investor requirement for a return sufficient to cover operating expenses includes debt service, dividends on stock, and continued assurance in the utility's ability to maintain credit and attract capital.<sup>49</sup> A just and reasonable return should be similar to returns on investments in other businesses having corresponding risk.<sup>50</sup>

53. CenterPoint requested a return on equity (ROE) figure of 11.25%, supported by the analysis of its witness, Dr. Samuel Hadaway. In calculating the proposed ROE, Dr. Hadaway utilized a Discounted Cash Flow ("DCF") analysis. Dr. Hadaway described DCF analysis as being "predicated on the concept . . . that a stock's

<sup>44</sup> CenterPoint Reply Brief, at 4.

<sup>45</sup> Minn. Stat. § 216B.03 (2005).

<sup>46</sup> Minn. Stat. § 216B.16, subd. 6 (2005).

<sup>47</sup> Minn. Stat. § 216B.03 (2005).

<sup>48</sup> **Bluefield Waterworks & Improvement Co. v. Public Service Commission of West Virginia**, 262 U.S. 679, 693 (1923).

<sup>49</sup> **Federal Power Commission v. Hope Natural Gas Co.**, 320 U.S. 591 (1944).

<sup>50</sup> *Id.* at 603.

price represents the present value of all future cash flows expected from the stock.”<sup>51</sup> DCF, simply speaking, estimates dividend yield plus the stock’s growth rate, by assuming either long-term constant growth or fluctuating (multi-stage) growth rates. In order to exercise informed judgment about capital market costs and the expectations for long-range growth rates, Dr. Hadaway initially used both the constant growth and multistage growth DCF models in his analysis. The results of these models were then compared to market-based risk premiums and projected economic conditions.<sup>52</sup> Dr. Hadaway then rejected the results of the constant growth DCF model, due to his perception that the resulting return was too low.<sup>53</sup> The multistage DCF analyses resulted in a reasonable return on equity range of 10.0% to 10.6%. With the use of long-term forecasted growth in gross domestic product (GDP) in a constant growth model he arrived at return on equity from 10.4% to 11.0%. Dr. Hadaway blended the two results for a final DCF range of 10.0% to 11.0%. Adding a further risk premium assessment, Dr. Hadaway concluded that an ROE of 11.25% reflects the cost of capital for an investment with the mix of risks currently faced by CenterPoint.<sup>54</sup>

54. To arrive at the 11.25% figure, Dr. Hadaway relied on ranges of ROEs from two comparison groups. One group, the S&P Gas Utilities group (“S&P Group”), was comprised of fifteen companies. The S&P Group averaged a 2005 projected growth rate of 6.4% (down from 8.0% in 2001). The other group was a subset of the S&P Group, comprised of utilities with 66% of revenue from regulated gas operations (66% Group). The 66% Group averaged a 2005 projected growth rate of 4.6% (down from 7.5% in 2001).<sup>55</sup> To arrive at the proposed ROE, Dr. Hadaway took the DCF projected results and added an equity risk premium resulting in a ROE range of 10.75% to 11.25%. He concluded that 11.25% was the reasonable cost of equity due to risks and uncertainty in the natural gas business.<sup>56</sup>

55. Combining CenterPoint’s hypothetical capital structure with the ROE derived from his analysis, Dr. Hadaway concluded that the overall cost of capital was 8.51% for the test year 2006, broken out as follows:

#### **CenterPoint’s Cost of Capital Proposal**

<u>Component</u>	<u>Percent of Total</u>	<u>Cost Rate</u>	<u>Weighted ROR</u>
Long-Term Debt	47.27%	5.78%	2.73%
Short-Term Debt	2.60%	5.20%	0.14%
Common Stock Equity	50.13%	11.25%	5.64%
Total Rate of Return (ROR)			8.51% <sup>57</sup>

<sup>51</sup> Ex. 29, Hadaway Direct, at 19.

<sup>52</sup> Ex. 29, Hadaway Direct, at 24.

<sup>53</sup> Ex. 29, Hadaway Direct, at 34-35.

<sup>54</sup> Ex. 29, Hadaway Direct, at 38-39.

<sup>55</sup> Ex. 29, Hadaway Direct, Schedule SCH-3.

<sup>56</sup> Ex. 29, Hadaway Direct, at 38-39.

<sup>57</sup> CenterPoint Brief, at 41.



56. While agreeing with CenterPoint on the expected cost rate of long-term and short-term debt, the Department disagreed with the proposed ROE. The Department initially recommended an ROE of 9.98%, (later updated to 9.71%). The Department relied upon the analysis of Dr. Marlon Griffing in support of its proposed ROE. Dr. Griffing also used a DCF analysis in calculating the Department's proposed ROE. For his DCF analysis, Dr. Griffing used a single comparison group ("Comparison Group") comprised of all natural gas local distribution companies ("LDCs") meeting certain standards that were listed in a S&P database.<sup>58</sup> Dr. Griffing used the constant growth version of the DCF analysis to calculate CenterPoint's ROE.<sup>59</sup>

57. Dr. Griffing's Comparison Group was comprised of those listed LDCs that were classified under the Standard Industrial Classification (SIC) code 4924 (natural gas distribution). The LDC must also have publicly traded shares and currently pay dividends. To be included in the Comparison Group, the LDC must have a S&P bond rating between AA- and BBB+. Dr. Griffing excluded any LDC from the Comparison Group if the company was expected to merge with another company or be acquired.<sup>60</sup>

58. The Comparison Group screening criteria were intended to limit the LDCs used for ROE analysis to those companies that are similar to CenterPoint and whose equity valuations are not unduly influenced by unusual market activity. Use of the bond rating standard was intended to limit the Comparison Group to those LDCs with similar investment risk to that of CenterPoint.<sup>61</sup>

59. Eighteen LDCs were listed in SIC code 4924. Dr. Griffing added one LDC, Keyspan Corp., to the list, since that company is similar to CenterPoint and that company was included in both Dr. Hadaway's S&P Group and 66% Group. Three LDCs were removed since they were not paying dividends. One LDC lacked a debt rating. Another LDC, Nicor, Inc., had a debt rating higher than the selected range. One LDC, Atmos Energy Corp., had a debt rating below the selected range. To further focus the Comparison Group on LDCs that are similar to CenterPoint, Dr. Griffing excluded non-U.S. based companies and those without a minimum of 70% net income/operating income from regulated LDC operations. These additional criteria excluded four LDCs (Keyspan among them).<sup>62</sup>

60. The Comparison Group as finally constituted had nine LDCs, including Peoples Energy. After his initial analysis, Dr. Griffing noted that Peoples Energy had agreed to customer refunds totaling \$100 million and to forgo collection of \$200 million in bad debt. From this information, Dr. Griffing concluded that Peoples Energy was not a comparable utility to CenterPoint and excluded its financial information from the DCF

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<sup>58</sup> Ex. 80, Griffing Direct, at 9-10.

<sup>59</sup> Hearing Tr. Vol. 3, at 201-202.

<sup>60</sup> Ex. 80, Griffing Direct, at 10.

<sup>61</sup> Ex. 80, Griffing Direct, at 10.

<sup>62</sup> Keyspan later announced plans to be acquired by another company, which is a further ground for excluding that company from the Comparison Group. Ex. 84, Griffing Surrebuttal, at 5.

calculation.<sup>63</sup> Dr. Griffing kept Peoples Energy in the Comparison Group for illustrative purposes only.<sup>64</sup> All of the Comparison Group LDCs were in the S&P Group. Five LDCs in the Comparison Group were in the 66% Group.<sup>65</sup>

61. The average projected growth rate of the Comparison Group was 5.7% (compared to 6.4% for the S&P Group and 4.6% for the 66% Group).<sup>66</sup> Using the growth rate estimates and anticipated dividend yields for the Comparison Group, Dr. Griffing established a range of ROEs. The range extended from a low of 9.28% to a high of 10.14%. The numerical midpoint of the range, 9.71%, was chosen as the ROE appropriate for CenterPoint.<sup>67</sup>

62. CenterPoint asserted that the Department's approach in establishing a comparison group and the methodology used in arriving at a proposed ROE understated CenterPoint's business risks. Higher risk generally requires a higher ROE to attract capital. CenterPoint asserted that the higher basic charges and the presence of weather normalization in some utilities' rate designs are risk-abating factors that are not present in CenterPoint's situation. Thus, CenterPoint maintains, its ROE should be at the high end of the ROE calculations.<sup>68</sup>

63. The Department objected to CenterPoint's positions regarding higher risk. Dr. Griffing noted that Dr. Hadaway uses a risk premium DCF model that includes a subjective perception of forward-looking risk.<sup>69</sup> Since the DCF model already includes investor risk in the analysis, the Department maintains that adding a risk premium is "employing double-counting" the effect of risk on ROE.<sup>70</sup> The Department also objected to CenterPoint's use of multiple DCF analyses as applying subjective judgment to result in the highest possible ROE.<sup>71</sup>

64. Dr. Griffing used the range of recent utility ROE awards as a reasonableness check on the DCF modeling results. Using fifteen awards identified in Public Utilities Fortnightly and a survey by Regulatory Research Associates, a range of 9.5% to 10.5% resulted. Dr. Griffing noted that both his initially proposed ROE (9.98%) and his updated ROE (9.71%) fell in the range of awards, although at the lower end of that range.<sup>72</sup> He also noted that Dr. Hadaway's most recent information (from the third and fourth quarters of 2005), included six awards ranging from 9.45% to 10.0%.<sup>73</sup>

65. CenterPoint objected to the Department's approach, maintaining that Dr. Hadaway's use of multiple tools was a "check on reasonableness," that his use of

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<sup>63</sup> Ex. 84, Griffing Surrebuttal, at 6.

<sup>64</sup> Ex. 84, Griffing Surrebuttal, MFG-S-5.

<sup>65</sup> Ex. 80, Griffing Direct, at 11-15; Ex. 29, Hadaway Direct, Schedule SCH-3.

<sup>66</sup> Ex. 84, Griffing Surrebuttal, at 6.

<sup>67</sup> Ex. 84, Griffing Surrebuttal, at 6.

<sup>68</sup> CenterPoint Brief, at 30.

<sup>69</sup> Ex. 84, Griffing Surrebuttal, at 14.

<sup>70</sup> Department Reply Brief, at 17.

<sup>71</sup> Department Reply Brief, at 15.

<sup>72</sup> Ex. 84, Griffing Surrebuttal, at 14.

<sup>73</sup> Ex. 30, Hadaway Rebuttal, Ex. 84, Griffing Surrebuttal, at 15.

“informed judgment” results in a better forecast, and that his result is more in keeping with ratemaking precedent.<sup>74</sup> The Department’s approach was criticized as relying on a single formula, failing to apply checks of reasonableness, and resulting in “an apparent ‘race to the bottom.’”<sup>75</sup>

66. The Department identified five specific shortcomings with Dr. Hadaway’s approach:

- 1) It uses an input, GDP growth rate, that is not a reasonable measure of expected growth for natural gas LDCs and inflates his outcomes. See DOC Ex. 80 at 43-44 (Griffing Direct); DOC Ex. 84 at 18-19 (Griffing Surrebuttal); and Department Initial Br. at 28-29.
- 2) His risk-premium analysis relies on a number that includes 120 unsubstantiated basis points. See DOC Ex. 80 at 50 (Griffing Direct); and Department Initial Br. at 29-30.
- 3) His rejection of his DCF constant-growth results is based on his unreasonable risk-premium number. See CenterPoint Initial Br. at 28.
- 4) No consideration is given to the viewpoint that it is the risk-premium number that is too high rather than the DCF number that is too low. See CPE Ex. 29 at 34-35 (Hadaway Direct)
- 5) He uses interest rates and general economic trends as a reason for pushing his risk-premium result to the top of his “Judgment of ROE Range,” thus incorporating these factors twice in his analysis. See DOC Ex. 80 at 51-53 (Griffing Direct); DOC Ex. 84 at 18-20 (Griffing Surrebuttal); and Department Initial Br. at 30.<sup>76</sup>

67. The Commission has recently addressed the issue of risk assessment in ROE calculation. The Commission stated:

The Department did not ignore the four risks asserted by the Company, but (as noted above) addressed each one, demonstrating in each instance that the asserted factor was either nonimpacting or negligibly impacting and would have been taken into account by Standard & Poor’s in setting relevant bond ratings. The Department and the ALJ also properly noted that in selecting to emphasize only four of the multiple factors involved in risk assessment, the Company has sought a one-sided and incomplete consideration of risk that would effectively double count factors already taken into account.<sup>77</sup>

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<sup>74</sup> CenterPoint Brief, at 24.

<sup>75</sup> CenterPoint Brief, at 25.

<sup>76</sup> Department Reply Brief, at 19.

<sup>77</sup> ***In the Matter of a Petition by Great Plains Natural Gas Company, a Division of MDU Resources Group, Inc., for Authority to Increase Natural Gas Rates in Minnesota***, Docket No. G-004/GR-04-1487, at 9 (Findings of Fact, Conclusions of Law, and Order issued May 1, 2006) (***Great Plains***).

68. The use of multiple forecasting tools, the selective rejection of results, and the additional consideration of risk are all indicative of efforts to substitute judgment for analysis. CenterPoint's finally proposed ROE, 11.25%, exceeds even the range of results achieved by the weighted DCF analysis relied upon by CenterPoint's expert. Comparison of Dr. Griffing's results with the range of ROE actually awarded in other jurisdictions is strong evidence that his results reflect an appropriate range of returns that are sufficient to attract investment capital. Applying the midpoint of the range for the actual ROE is a reasonable means of assuring that the interests of shareholders and ratepayers are balanced. The Department's proposed ROE of 9.71% is reasonable.

69. Calculation of the allowable rate of return (ROR) is derived by multiplying each capital structure component by the cost of that component, then adding the results to arrive at the ROR for that particular utility.<sup>78</sup> The Department and CenterPoint agreed that the cost of long-term debt was appropriately 5.78% and the cost of short-term debt was appropriately 5.20%.<sup>79</sup> The Department proposed the following cost of capital structure for establishing CenterPoint's rates:

#### **Department's Cost of Capital Proposal**

<u>Component</u>	<u>Percent of Total</u>	<u>Cost Rate</u>	<u>Weighted ROR</u>
Long-Term Debt	44.134%	5.78%	2.56%
Short-Term Debt	12.22%	5.20%	0.64%
Common Stock Equity	43.47%	9.71%	4.22%
Total Rate of Return (ROR)			7.42% <sup>80</sup>

70. As discussed in foregoing findings, the capital structures proposed by the Department and CenterPoint vary widely. The most important differences are between the levels of common stock equity and short-term debt in each calculation. These differences account for most of the wide disparity between the two parties' ROR calculation. Applying the Department's proposed ROE to the hypothetical common stock equity level ordered by the Commission (and subtracting the difference from the short-term debt figure calculated by the Department) results in an ROR of approximately 7.7%. Applying the range of reasonableness check, 7.7% would fall in the middle range of the actual awards identified by both CenterPoint and the Department. This outcome also conforms to the 8.03% ROR in the settlement of the **2004 CenterPoint Rate Matter**.<sup>81</sup> Had CenterPoint operated in the manner envisioned in the **2003 Reliant Energy Minnegasco Inquiry Order**, the 7.7% ROR would be appropriate.

<sup>78</sup> Ex. 84, Griffing Surrebuttal, at 12.

<sup>79</sup> Ex. 84, Griffing Surrebuttal, at 12

<sup>80</sup> Ex. 84, Griffing Surrebuttal, at 12; Department Brief, at 13.

<sup>81</sup> Ex. 13, Hadaway Rebuttal, SCH-R, Schedule 1, at 2.

71. CenterPoint agreed to a compliance filing to demonstrate that it is operating with a 50% equity/50% debt ratio.<sup>82</sup> If the Commission approves of this procedure, the appropriate cost of capital calculation pending CenterPoint's filing is as follows:<sup>83</sup>

#### **Department's Alternative Cost of Capital Proposal**

<u>Component</u>	<u>Percent of Total</u>	<u>Cost Rate</u>	<u>Weighted ROR</u>
Long-Term Debt	47.27%	5.78%	2.73%
Short-Term Debt	2.60%	5.20%	0.14%
Common Stock Equity	50.13%	9.71%	4.87%
Total Rate of Return (ROR)			7.74% <sup>84</sup>

72. The revenue requirement for CenterPoint in this rate matter should be adjusted to reflect the capital structure ultimately chosen. The record supports the cost rates advanced by the Department for calculating CenterPoint's ROR.

#### **G. Existing Rate Structure**

73. Prior to approval of CenterPoint's interim rate, the Company's natural gas rate structure consisted of the wholesale cost, basic charges, and a delivery rate. The basic charge and delivery rate constitute the delivery charge portion of the customer bill. The wholesale cost to CenterPoint for the natural gas sold to customers is passed through in customer bills without markup. Thus, the delivery charge must account for CenterPoint's costs of providing natural gas service and CenterPoint's return.<sup>85</sup>

#### **Basic Charge**

74. The basic charge is the amount paid monthly by any customer connected to CenterPoint's gas distribution system. This charge is paid independent of gas usage. For residential customers in both the Northern Service Area (Northern customers) and the Viking Service Area (Viking customers), the charge is \$6.50 per month. This charge was increased from the previous level of \$5.00 as the result of the **2004 CenterPoint Rate Matter**. The \$6.50 per month basic charge took effect on August 12, 2005.<sup>86</sup> For commercial classes of customers in both Northern and Viking areas, the customer basic charge is accompanied by a basic transportation service charge that varies depending on customer class and service area.<sup>87</sup>

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<sup>82</sup> CenterPoint Reply Brief, at 4.

<sup>83</sup> Department Brief, at 21-22.

<sup>84</sup> Ex. 84, Griffing Surrebuttal, at 12; Department Brief, at 13.

<sup>85</sup> Ex. 12, Hammond Direct, at 19-20; Hearing Tr., Vol. 1, at 36-39.

<sup>86</sup> Ex. 1, Binder 1, Proposed Tariffs.

<sup>87</sup> Ex. 1, Binder 1, Proposed Tariffs.

## **Delivery Rate**

75. The remaining portion of the customer bill is the delivery rate. This charge is calculated by multiplying the therms in the natural gas purchased by an established rate.<sup>88</sup> For Northern customers, the current rate is \$0.11928. For Viking customers, that rate is \$0.09093.<sup>89</sup> Commercial classes pay a rate (with one exception) ranging from \$0.11654 to \$0.03731. The exception is for large general service customers which pay a demand peak rate of \$0.59926 (Northern) or \$0.69326 (Viking).<sup>90</sup>

## **H. Test Year**

76. CenterPoint projected a test year for calculation of the proposed rates in this matter. The Company began with the actual financial information for the calendar-year base period ending December 31, 2004. This information was adjusted to eliminate out-of-period expenses from the calculation. A normal operating year adjustment was made to address known changes in operating conditions for the regulated utility portion of CenterPoint's business. The resulting information was corrected for inflation. The year ending on December 31, 2006 was used as the projected test year.<sup>91</sup>

77. Almost three-quarters of CenterPoint's natural gas sales are identified as "heat sensitive." These are sales that fluctuate based on the actual temperature of the local weather. Heat sensitive sales account for approximately 70 percent of total sales in the test year.<sup>92</sup> CenterPoint used a ten-year rolling average to derive the temperatures to be applied in the test year. The 35-year period from 1970 through 2004 showed a statistically significant mean reduction in heating-degree days (meaning the temperature was warmer), particularly over the last decade. CenterPoint attributed this statistically significant reduction in heating-degree days to global climate change, which is seen as causing a warmer climate in CenterPoint's service area.<sup>93</sup>

78. In addition to the reduction in heating-degree days, CenterPoint maintained that new construction is increasingly multi-unit housing, thereby increasing efficiency and reducing the heating needs of residential customers in CenterPoint's service area. Increases in the overall cost of natural gas, prompting consumers to conserve energy, and the widespread improvement in energy-efficient appliances and building practices were cited as additional factors reducing the anticipated demand for natural gas in the test year.<sup>94</sup>

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<sup>88</sup> One therm is equal to 100,000 BTU's. CenterPoint calculates the therm value of gas provided by sampling delivered gas for its BTU content per cubic foot and multiplying that value by the cubic feet actually delivered to a customer.

<sup>89</sup> Ex. 1, Binder 1, Proposed Tariffs.

<sup>90</sup> Ex. 1, Binder 1, Proposed Tariffs; Ex. 12, Hammond Direct, at 20.

<sup>91</sup> Ex. 12, Hammond Direct, at 4.

<sup>92</sup> Ex. 12, Hammond Direct, at 4-7.

<sup>93</sup> Ex. 18, Yang Direct, at 12-16, Schedule 2.

<sup>94</sup> Ex. 18, Yang Direct, at 4-11.

79. CenterPoint separately forecast the anticipated usage by Large Volume Dual Fuel (LVDF) customers, assessing the particular needs of each customer in making adjustments from prior usage patterns. The Department inquired of the method used by CenterPoint to adjust its forecast. CenterPoint provided documentation of the reasons for each change. Based on the information provided, the Department agreed with CenterPoint's LVDF forecast.<sup>95</sup>

80. The use of ten-year rolling averages was criticized by the Department as unreasonably sensitive to updates in the data. The Department used twenty-year weather data.<sup>96</sup> OAG disputed CenterPoint's position on multi-unit housing construction.<sup>97</sup>

81. CenterPoint forecasted that the total volume of natural gas delivered to customers would amount to 157,653,000 Dkt in the test year.<sup>98</sup> This forecast was based on 795,075 customers, with econometric modeling done for small service classes (residential and small commercial) and individual customer forecast sales for large volume customers.<sup>99</sup> CenterPoint used eight years of customer data and the 10-year rolling average for weather.<sup>100</sup>

82. Using its regression analysis, the Department forecast the total volume of natural gas sales to be 157,963,000 Dkt in the test year. CenterPoint accepted the Department's forecast for the purposes of this rate matter, while not agreeing with the Department's methodology. Use of the Department's forecast requires an increase in the cost of gas of \$1,469,040 and an increase in operating revenue of \$1,717,070. These changes result in a net required revenue reduction of \$248,030.<sup>101</sup>

83. The Commission questioned whether modeling normal weather on the basis of ten years of data rather than twenty is reasonable. With the agreement to use the Department's twenty-year result, there is an insufficient record to reach a firm conclusion on that issue. The similarity between the two results does suggest that the ten-year model is reasonable.

#### **I. Test Year Revenue, Expenses and Operating Income**

84. CenterPoint calculated its test year expenses to be \$1,685,811,000 and that the forecast test year operating revenue is \$1,656,434,000, resulting in an operating income of \$29,377,000.<sup>102</sup>

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<sup>95</sup> Ex. 75, Chavez Direct, at 24-26.

<sup>96</sup> Ex. 75, Chavez Direct, at 17, 20.

<sup>97</sup> OAG Brief, at 23-25.

<sup>98</sup> Ex. 18, Yang Direct, at 29. "Dkt" stands for dekatherm, with a conversion factor of 1 Dkt equaling 10 therms.

<sup>99</sup> Ex. 18, Yang Direct, Schedules 6 and 7.

<sup>100</sup> Ex. 18, Yang Direct, at 16, Schedule 3.

<sup>101</sup> Ex. 75, Chavez Direct, at 28-29.

<sup>102</sup> Ex. 12, Hammond Direct, PRH-D, Schedule 2.

85. CenterPoint calculated the commodity price of gas to be \$9.588 per Dkt, based on NYMEX market data, resulting in a test-year commodity cost of \$1,334,005,384.<sup>103</sup> The Department calculated the price to be \$8.515 per Dkt, based on a different forecast.<sup>104</sup> Energy CENTS arrived at a price of \$8.98/Dkt, using the Henry Hub price.<sup>105</sup>

86. Further analysis by the Department of the pricing information presented resulted in a proposed cost of gas of \$9.052/Dkt.<sup>106</sup> CenterPoint, the Department, and Energy CENTS reached consensus that the commodity price of gas should be forecast at \$9.052/Dkt.<sup>107</sup> That cost is reasonable and should be approved.

## **J. Revenue Requirements**

87. For the test year (using existing rates) CenterPoint calculated that its operating income of \$29,377,000 would result in an overall rate of return of 4.69%, CenterPoint maintains that 8.51% is the rate of return that is required for just and reasonable rates. To achieve that rate of return, CenterPoint calculated that revenue of \$53,334,000 would be required, leaving a net shortfall of \$23,967,000. CenterPoint calculated the gross revenue conversion factor to be 1.7056.<sup>108</sup> The net shortfall, multiplied by the gross revenue conversion factor, results in an overall claimed revenue deficiency of \$40,878,000.<sup>109</sup>

88. CenterPoint maintains that four discrete factors have prompted this rate request. Declining residential customer use, together with reductions from the other small, firm-volume business classes has led to reduced sales from the forecast levels. CenterPoint has experienced increased bad debt expenses over its anticipated levels. The increased capital costs, including replacement expenses for the defective equipment installed for Midwest Gas, have increased CenterPoint's expenses over the forecast levels. The higher forecast wholesale cost of natural gas in the test year increases the costs CenterPoint incurs for working capital. For these reasons, CenterPoint maintains that the revenue established from the **2004 CenterPoint Rate Matter** is now insufficient.<sup>110</sup>

## **K. Customer Cost of Service Study**

89. In preparation for this rate application, CenterPoint conducted a customer cost of service study (CCOSS). The CCOSS analyzed CenterPoint's administrative and operating costs and attempted to associate identifiable costs with the particular class of customer triggering the cost. In this proceeding, CenterPoint used the same model as in the **2004 CenterPoint Rate Matter**. CenterPoint described the model as using cost

<sup>103</sup> Ex. 28, Fransdal Rebuttal, at 7

<sup>104</sup> Department Brief, at 69; Ex. 75, Chavez Direct, at 36.

<sup>105</sup> Ex. 48, Duffrin Direct, at 3.

<sup>106</sup> Ex. 79, Chavez Surrebuttal, at 9.

<sup>107</sup> Hearing Tr. Vol. 1, at 225 (Fransdal) and Hearing Tr. Vol. 2, at 189-190 (Duffrin).

<sup>108</sup> Ex. 1, Binder 1, Tab F.

<sup>109</sup> Ex. 12, Hammond Direct, PRH-D, Schedule 2.

<sup>110</sup> Ex. 12, Hammond Direct, at 9.



causation as the controlling element of the cost classification and cost allocation process.<sup>111</sup> The CCOSS was updated from the prior rate matter by changing the allocation mechanism to the rate base to assign responsibility for income taxes.<sup>112</sup>

90. This method is appropriate, CenterPoint asserts, because required income is determined by applying an allowed rate of return to the rate base number. Since income tax expense for the test year is positive, CenterPoint maintains that the various classes of service should also have a positive allocation. To achieve this result, CenterPoint allocated income tax to the various customer classes in the same percentage as that class is represented in CenterPoint's rate base. CenterPoint maintains that subsidies for one class of service result in an inappropriate credit and that this burdens all other classes with an income tax expense obligation.<sup>113</sup> Based on its CCOSS, CenterPoint concluded that the monthly cost of serving the General Service (Residential and Commercial) customers was \$20.47.<sup>114</sup>

91. The Department accepted CenterPoint's CCOSS.<sup>115</sup> Energy CENTS objected to CenterPoint's tax allocation for the CCOSS. This methodology, Energy CENTS maintains, is unsupported and results in a residential cost of service that is contrary to the actual costs of serving those customers.<sup>116</sup>

92. Energy CENTS points out that actual taxes are paid on taxable income. Taxable income is determined by the pre-tax income received by a company. It is not determined by "required income," which is a figure determined in a rate case. If the overall pre-tax income were negative, it would result in a tax credit for the company. Energy CENTS maintains that the same logic should apply when allocating tax expense across customer classes. If the taxable income would result in a tax credit for a certain class, the credit should be reflected in the CCOSS. Energy CENTS continues to urge the Commission to reject CenterPoint's proposal to link income tax expense to the rate base.<sup>117</sup>

93. Income tax is based on revenue, net of costs. CenterPoint does not operate as separate businesses with regard to its different customer classes. By using its rate base as the measure for tax allocation in the CCOSS, tax costs are distributed across each customer class in an equitable fashion. Allocation of income tax expenses based on the rate base is supported by CenterPoint's analysis.

## **L. Initial Rate Proposal**

94. The Company initially proposed an overall rate increase of 2.4% over test year gross revenues, resulting in an increase of \$40,878,000.<sup>118</sup> This proposal includes

<sup>111</sup> Ex. 12, Hammond Direct, at 17.

<sup>112</sup> Ex. 13 Hammond Rebuttal, at 2.

<sup>113</sup> Ex. 13 Hammond Rebuttal, at 2.

<sup>114</sup> Ex. 12, Hammond Direct, Schedule 8, at 4..

<sup>115</sup> Ex. 74, Bonnett Surrebuttal, at 2.

<sup>116</sup> Energy CENTS Reply Brief, at 10-12.

<sup>117</sup> Ex. 48, Dufferin Direct, at 18-19; Energy CENTS Brief, at 32.

<sup>118</sup> Ex. 1, Binder 1, Notice of Change in Rates.

an increase in rates for the Residential Class of 3.3% in the Northern Area and 5.7% in the Viking Area.<sup>119</sup> The residential rate design includes a proposed increase in the monthly basic charge from \$6.50 to \$8.00. CenterPoint also proposed to change the delivery rate from a flat charge of \$0.09093 per therm to a modified inverted block rate system. This approach imposes a delivery charge of \$0.21000 per therm on the first unit of therms (in this instance, 18 therms), decreasing to \$0.12000 per therm on the next unit of therms (here 82 therms). The delivery charge then rises to \$0.12500 per therm on the third unit of therms (150 therms). Once the residential customer reaches 250 therms of usage, the delivery rate returns to \$0.21000 per therm.<sup>120</sup>

95. CenterPoint also proposed increases to the rates for business classes of customers. The largest proposed increases are in the Viking Area for Commercial/Industrial Firm A (C/I A), 9.1%, and Commercial/Industrial Firm B (C/I B), 6.7%. In the combined assessment for both service areas, the increases were 3.3% for C/I A, and 1.7% for C/I B. Smaller increases were proposed for the remaining classes.<sup>121</sup>

## **M. Revenue Requirements Generally**

96. The methodology for setting rates generally relies on dividing estimated future costs over estimated future sales. The result determines the actual rates to be charged. Volumetric sales estimates are very important in determining the appropriate rates to be set. Overestimating sales can result in a utility failing to receive an appropriate return on investment. Underestimating sales can result in the recovery of a higher rate of return than the return authorized by the Commission. Issues regarding sales forecasts by CenterPoint and the Department for the 2005 test year differed and are discussed in other findings.

### **Rate Base**

97. In setting rates for a public utility, the Commission must determine the total level of investment by the utility in its “utility property used and useful in rendering service to the public.”<sup>122</sup> In utility rate cases, such investments are referred to as the utility’s rate base.<sup>123</sup> CenterPoint’s initial filing maintained that the test year rate base for the 12 month period ending December 31, 2006 amounted to \$626,844,000.<sup>124</sup> CenterPoint used the same methodology to determine the rate base as that utilized in the **2004 Rate Matter**.<sup>125</sup>

98. The Department proposed several adjustments to CenterPoint’s rate base. First, the Department recommended that the proposed beginning of test year rate base

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<sup>119</sup> Ex. 1, Binder 1, Tab E.

<sup>120</sup> Ex. 1, Binder 1, Proposed Tariffs.

<sup>121</sup> Ex. 1, Binder 1, Proposed Tariffs.

<sup>122</sup> Minn. Stat. § 216B.16, subd. 6.

<sup>123</sup> Hearing Tr. Vol. 3, at. 212.

<sup>124</sup> Ex. 31, Nesvig Direct, at 77 and Schedules 46, 47, 52-60, 62 and 64.

<sup>125</sup> Ex. 31, Nesvig Direct, at 77.

figure (as projected in CenterPoint's November 2, 2005 filing in this matter) be adjusted to "recognize the actual 2005 ending plant balance excluding the \$1,991,000 of inspection and clerical expense ..."<sup>126</sup> This adjustment was based on the Department's assessment that CenterPoint's actual 2005 capital expenditures were substantially less than CenterPoint's original projection. CenterPoint acknowledged that its actual 2005 total capital expenditures fell \$7.3 million short of the projected figure.

99. CenterPoint maintained that this difference was more than outweighed by the Company's investment in its new billing system, originally projected to have a cost of approximately \$11.5 million projected for 2005, but ultimately placed in service at a total cost of approximately \$14.4 million in January 2006.<sup>127</sup> The Department responded that the half year convention for the \$14.4 million be recognized in CenterPoint's rate base.<sup>128</sup>

100. The Department has not suggested that CenterPoint capture each of the changes in investment that have occurred. The Department's approach has been to adjust to what is now known to be the actual rate base beginning balance. To this actual figure, the Department proposes to add the higher new billing system total cost and the Midwest Project additions. The Department is proposing to remove the cash remittance equipment and the related decrease in test year expenses. The Department maintains that its suggested adjustments do not constitute an impractical and impossible task. The Department maintains that ignoring CenterPoint's overstatement of the test year rate base would be unreasonable.<sup>129</sup>

101. Forecasting necessarily carries a degree of uncertainty. Changes between anticipated costs and actual costs are inevitable. Because the rates being set are carried forward over a period of years, there is a need to ensure that the starting point is as accurate as possible. Where known significant changes can be identified, adjusting the starting point is appropriate. The Department's suggested alterations more accurately reflect CenterPoint's rate base and should be adopted.

### **Midwest Gas Replacement Project**

102. On December 28, 2004, a natural gas fitting at a business in Ramsey, Minnesota failed, resulting in an explosion that killed three persons and injured a third ("Ramsey Incident"). The subsequent investigation determined that a fitting had been improperly installed in such a manner that a sudden, catastrophic failure could occur. CenterPoint had conducted a leak test in the area of the Ramsey Incident on April 9, 2004 and found no leakage.<sup>130</sup>

103. The improper fittings had been installed in 1980 by a predecessor company, acquired by CenterPoint in 1993. Records of the installations indicated that a

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<sup>126</sup> Ex. 62, St. Pierre Surrebuttal, at 10.

<sup>127</sup> CenterPoint Brief, at 43.

<sup>128</sup> Hearing Tr. Vol. 3, at. 120-123..

<sup>129</sup> Department Reply Brief, at 6.

<sup>130</sup> Ex. 22, MNOPS Pipeline Incident Report at 13.

large number of service lines, up to 33,000, could be affected by the improper fittings.<sup>131</sup> In May 2005, the Minnesota Office of Pipeline Safety ("MNOPS") issued a Compliance Order to address the problem identified in the Ramsey Incident. The MNOPS Order required that CenterPoint replace or visually inspect all plastic service lines installed prior to 1984 by North Central Public Service Company. CenterPoint was also obligated to maintain detailed records of what was found and what remedial measures were taken.<sup>132</sup>

104. Under the direction of the MNOPS Order, CenterPoint initiated the Midwest Gas Replacement Project. The Midwest Gas Replacement Project inspected over 30,000 service lines and replaced those lines where needed.

105. CenterPoint included \$39,536,861 as actual 2005 and projected 2006 tangible capital expenditures in its rate base arising from the Midwest Gas Replacement Project.<sup>133</sup> SRA maintained that none of this amount was appropriate for inclusion in the rate base as the acquisition was negligently made.<sup>134</sup> SRA also maintained that a decision by the Commission allowing recovery of the costs for the Midwest Gas Replacement Project could prejudice CenterPoint's effort to recover alleged overpayments for the value of the property from the seller.<sup>135</sup> OAG agreed that third-party recovery had not yet been exhausted by CenterPoint and that prior Commission decisions had tracked recoveries for inclusion in subsequent rate cases.<sup>136</sup>

106. OAG maintained that none of the expenditures regarding the Midwest Gas Replacement Project should be included in the rate base at this time. CenterPoint's inability to describe the specifics of the Project is cited by OAG as CenterPoint failing to meet its burden of proof that these costs are appropriate. OAG recommended that the Commission open another docket to examine the costs of the Midwest Gas Replacement Project and determine which costs should be borne by ratepayers.<sup>137</sup>

107. The Department did not oppose inclusion of the Midwest gas replacement project costs in CenterPoint's rate base. The Department did suggest a number of reporting conditions regarding the project. Under these conditions, CenterPoint would record all dollars recovered through litigation or insurance and treat them as an offset to the associated plant in service. Interest would be calculated on the associated revenue requirement at the overall rate of return compounded annually. CenterPoint would file an annual report, beginning on May 1, 2007, on all amounts recorded as offsets to the associated plant and service. CenterPoint would include in its annual report a calculation on the impact of recoveries on the revenue requirement and on base rates

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<sup>131</sup> Ex. 22, MNOPS Pipeline Incident Report at 13.

<sup>132</sup> Ex. 24, MNOPS Compliance Order .

<sup>133</sup> Ex. 34 (note that actual amounts were listed, not truncated as indicated in the document header).

<sup>134</sup> SRA Reply Brief, at 1.

<sup>135</sup> SRA Reply Brief, at 2.

<sup>136</sup> OAG Reply Brief, at 8-9.

<sup>137</sup> OAG Reply Brief, at 4-7.

broken out by class.<sup>138</sup> This reporting would allow the Commission to determine if refunds to ratepayers were needed, on an annual basis.<sup>139</sup>

108. CenterPoint maintained that its expenditures were required by Minnesota law, which states:

Subd. 11. **Pipeline safety programs.** All costs of a public utility that are necessary to comply with state pipeline safety programs under sections 216D.01 to 216D.07, 299F.56 to 299F.64, or 299J.01 to 299J.17 must be recognized and included by the commission in the determination of just and reasonable rates as if the costs were directly incurred by the utility in furnishing utility service.<sup>140</sup>

109. The effect of the statute on ratemaking was assessed by the Minnesota Supreme Court, which stated:

The language of section 216B.16, subd. 11, is clear and unambiguous and, therefore, not subject to judicial interpretation. . . . The statute mandates that all costs necessary to comply with state pipeline safety programs are to be treated as if they were “directly incurred by the utility in providing service.”<sup>141</sup>

110. To the extent that CenterPoint’s costs are “necessary” for compliance with the pipeline safety obligations, the costs are recoverable through rates. CenterPoint has commenced a third party action against MidAmerican Energy Company, the successor to Midwest Gas.<sup>142</sup> Therefore, the Department recommended that the Commission require the Company to report to the Commission all third party recovery obtained, together with a proposal for returning any such recovery to ratepayers. CenterPoint agreed with the Department’s recommendation.<sup>143</sup>

111. CenterPoint acknowledged the goals behind the Department’s suggested approach to handling any third party recovery, stating:

Any dollars recovered through litigation or insurance would be recorded as an offset to capital/rate base. As proceeds reducing capital/rate base, if any, are collected, the Company proposes to calculate the associated revenue requirement impact on base rates annually. Interest on the revenue requirement at the prime interest rate will also be

<sup>138</sup> Department Reply Brief, at 7.

<sup>139</sup> Ex. 62, St. Pierre Surrebuttal, at 3-4.

<sup>140</sup> Minn. Stat. 216B.16, subd. 11.

<sup>141</sup> *Minnegasco v. Minnesota Public Utilities Commission*, 549 N.W.2d 904, 910 (Minn. 1996).

<sup>142</sup> *Lyla Burkman, as Trustee for the Heirs and Next-of-Kin of Lorraine Melton, deceased v. CenterPoint Energy Resources Corp. d/b/a CenterPoint Energy, a Delaware corporation doing business in Minnesota v. MidAmerican Energy Company, an Iowa corporation a/k/a MidAmerican Energy and a/k/a Midwest Gas, a division of Midwest Power Systems, Inc.*, U. S. District Court File 06-CV-00325 (in which CenterPoint is seeking \$40 million in remediation costs).

<sup>143</sup> Hearing Tr., Vol. 1, at 79.

computed annually. When the proceeds result in a capital reduction of \$10 million or once litigation is complete, whichever occurs sooner, a refund will be made. At that time, the Company would calculate the impact on base rates and would file a timely request with the Commission to reduce its rates. Additionally, the Company would annually file a report with the Commission on the account balance and the results of any pending litigation or insurance claims.<sup>144</sup>

112. The agreed-upon approach to tracking recoveries is a reasonable method of refunding to customers the amounts collected in a timely fashion, without unduly burdening CenterPoint, and without causing confusion to customers by generating multiple adjustments to their billings. The refund mechanism ensures that the money recovered (if any) will be returned to customers. This proposal is reasonable, will prevent “double recovery,” and is appropriate for approval by the Commission.

113. CenterPoint has demonstrated that the costs of the Midwest Gas Replacement Project were necessary to comply with a State pipeline safety program. By statute, the costs must be recognized and included in the Commission’s determination of just and reasonable rates.<sup>145</sup>

114. The Department also recommended adjustment to CenterPoint’s rate base to deny capital treatment of roughly \$2 million related to certain expenses associated with the Midwest Project. CenterPoint expensed these items in 2005, but requested permission to capitalize them for ratemaking purposes, given the nature of the expenses. The Department objected to capitalizing these expenses. The Department maintained that such treatment would violate Generally Accepted Accounting Principles (“GAAP”).<sup>146</sup>

115. CenterPoint maintained that the rate base treatment of those expenses was appropriate, stating:

These costs were a necessary part of the replacement program. In most service line replacement projects we know what service line we are going to replace and where that service line is. In this case, we had to do a significant amount of work to define the population of service lines that had the potential to have improperly installed fittings. Once the potential population was identified, we then had to physically examine the service line to determine if it was constructed of plastic or steel and then whether it was composed of the particular type of plastic that was at risk. All of these costs were necessary just to determine which service line was to be replaced. They were critical to the implementation of the replacement plan and should be capitalized as a cost of the replacement plan.<sup>147</sup>

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<sup>144</sup> Ex. 13, Hammond Rebuttal , at 24-25.

<sup>145</sup> Minn. Stat. 216B.16, subd. 11.

<sup>146</sup> Ex. 62, St. Pierre Surrebuttal, at 8-10.

<sup>147</sup> Ex. 31, Nesvig Direct, at 81.

116. The Department responded that these additional expenses cannot be included in the rate base because they were incurred out of the test year period.<sup>148</sup> CenterPoint has demonstrated that these are known costs, incurred in a necessary remediation program. Affording these costs different treatment has not been shown reasonable.

### **Cash Remittance Equipment**

117. As part of its transfer of billing operations to Houston, Texas, CenterPoint also transferred its cash remittance processing equipment. CenterPoint acknowledged that the equipment was “retired after the filing of this case and after the beginning of the test year.”<sup>149</sup>

118. The Department urged that the ALJ take judicial notice of Docket No. G-008/AI-06-0560. CenterPoint’s Petition in the cited docket identified equipment that was no longer to be included in CenterPoint’s rate base.<sup>150</sup> The Department described the inclusion of amounts for this equipment in CenterPoint’s rate base as a “discrepancy in the amount the Company included in rate base for equipment that has been removed from rate base in the test year.”<sup>151</sup> The Company retired the equipment in January 2006 and, according to the Petition, transferred it to its affiliate CenterPoint Energy Service Co. (“Service Company”) in March 2006. In January 2006, Service Company began providing the cash remittance processing for CenterPoint Energy and allocating costs based on the service.

119. CenterPoint maintained that the Commission already rejected the Department’s requested treatment by not explicitly including this issue for the reopened hearing on the billing system in this matter.<sup>152</sup> The Department maintained that including additional amounts in rate base for CenterPoint’s billing system and the Midwest Project is unreasonable if a known substantial change that reduces the rate base is not accounted for. Failing to remove the cash remittance equipment net plant amount of \$274,403 would, in the Department’s assessment, amount to the double counting of plant. The Department also recommended reducing the income statement expenses by approximately \$66,000 for the reduction in costs related to the cash remittance being performed in Houston, Texas, instead of Minneapolis.<sup>153</sup> Therefore, the Department recommended that if the Commission allows the additional amounts in rate base of \$2,429,018 (for the differing amounts spent on the new billing system and the Midwest Gas Project) and related income statement costs then the rate base should also be reduced for the cash remittance equipment and the income statement should be reduced for the reduction in cash remittance processing costs. The Department

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<sup>148</sup> Department Reply Brief, at 6-8.

<sup>149</sup> CenterPoint Reply Brief, at 10.

<sup>150</sup> ***Petition for Approval of Affiliated Interest Agreement Between CenterPoint Energy and CenterPoint Energy Service Company to Transfer Cash Remittance Equipment***, No. G-008/AI-06-0560 (***Cash Remittance Petition***).

<sup>151</sup> Department Brief, at 36.

<sup>152</sup> CenterPoint Reply Brief, at 10.

<sup>153</sup> Department Brief, at 36 (*citing Cash Remittance Petition*, Department Comment filed July 11, 2006).

recommended that the Commission approve CenterPoint's proposed rate base, with the exception of the cash remittance equipment transferred from CenterPoint to the Service Company's books.<sup>154</sup>

120. CenterPoint argues that cash remittance processing is no different than hundreds of other issues in the rate case – during the course of the test year, some changes positively impact the Company's financial picture, and some changes negatively impact the Company's financial picture. Under this view, it is inappropriate and unreasonable to isolate one issue that may work to the Company's financial detriment without considering issues (such as continually rising interest rates or rising gasoline prices) which, if considered, would increase the Company's revenues. CenterPoint maintains that such a pursuit would lead to continual "updating" and result in the inability to ever close the record in a ratemaking proceeding.

121. As discussed in a foregoing finding, where known significant changes can be identified, adjustments to the underlying figures are appropriate. The Department's proposed exclusion of the cash remittance equipment is appropriate, particularly since CenterPoint controlled the timing of the change.

### **Customer Billing System**

122. CenterPoint placed a new billing system (known as the Customer Care and Service billing system or "CCS") into service in January 2006. Designed to support many different areas of the CenterPoint's operations, CCS is integral to the customer service function, including: management of meter reading schedules and data; calculation of billing amounts and printing of invoices; posting of customer payment files and payment programs; credit activities; customer requested work orders; direct customer contact; and online (internet) customer service.<sup>155</sup>

123. As part of the Commission's May 2006 review of CenterPoint's service quality reports, the Commission noted that issues had arisen regarding the implementation of CCS. On May 17, 2006, the Commission ordered further record development on CenterPoint's investment in and implementation of CCS.<sup>156</sup> Due to the differing nature of the two issues, prudence in investment is assessed here, and prudence in implementation is addressed in subsequent Findings.

124. In the additional proceedings conducted pursuant to the Commission's Order, no party challenged CenterPoint's prudence in investing in a new billing system. CenterPoint demonstrated that a functioning billing system is critical to the efficient provision of utility service. The legacy system supplanted by CCS had been in use for 23 years, used an old programming language, and relied on an obsolete file structure. The legacy system was difficult to maintain and very difficult to change in response to CenterPoint's needs. CenterPoint also experienced difficulty obtaining useful

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<sup>154</sup> Department Brief, at 36.

<sup>155</sup> Ex. 97, Pyles Supplemental, at 2-3.

<sup>156</sup> **2005 CenterPoint Rate Matter**, (Order Referring Prudence Issues Regarding Billing System Investment and Implementation to Administrative Law Judge for Discovery and Hearing issued May 17, 2006).



management reporting from the legacy system. CenterPoint demonstrated that replacement of the legacy system was prudent to address demonstrated limitations with that system and ensure the ongoing reliability customer service and billing functions.

125. CenterPoint adjusted its gross plant balance to reflect that CCS was not placed in service in 2005. The gross plant balance was again adjusted to add in the full amount of the costs of that system. \$14,374,000.<sup>157</sup> The Department agreed with the CenterPoint's rate base treatment of CCS (as shown in response to DOC IR No. 145), so long as the cash remittal equipment adjustment is made as well. Inclusion of CSS in the rate base as set out by the Department is appropriate.

### **Service Line Extensions**

126. Service line extensions are subject to a tariff that divides the financial responsibility for installing that infrastructure. CenterPoint pays for the initial portion of the installation and the customer receiving services is responsible for costs over the set length identified in the tariff. In response to an information request by the Department, CenterPoint performed a quantitative analysis to measure the cost and load justifications behind the extensions tariff. In a sampling of CenterPoint's application of that tariff for residential service, CenterPoint identified six errors. To assure that errors in applying the tariff do not impose a burden on other ratepayers, CenterPoint proposed a downward revision of \$89,807 to its rate base.<sup>158</sup> Two additional errors were identified in a main line commercial project and a residential service line project. No adjustment was proposed for either of these errors, since they both fall within the acceptable error rate of CenterPoint's sampling software.<sup>159</sup>

127. The Department concluded that the quantitative analysis demonstrated that CenterPoint's extensions tariff was justified, both for load and cost. The Department declined to endorse CenterPoint's proposed rates.<sup>160</sup> The Department agreed with CenterPoint's approach to sampling for determining errors in applying the extensions tariff. The Department did not object to CenterPoint's position on not adjusting for the two errors that were within the margin of error for the sampling software. The Department recommended approval of the downward rate base adjustment of \$89,807.<sup>161</sup>

128. As part of the settlement in the **2004 Rate Matter**, CenterPoint agreed to include an accounting of winter construction charges in its Annual Jurisdictional Report to the Commission. In this proceeding, CenterPoint proposed to discontinue that reporting. The Department opposed discontinuing that reporting. The Department also proposed that the Commission require CenterPoint to make a separate tariff filing. In this filing, CenterPoint would provide specific cost types of main line and service line extensions that occur in winter. The tariff filing would also include cost types for

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<sup>157</sup> Ex. 62, St. Pierre Surrebuttal, at 7-8.

<sup>158</sup> CenterPoint Brief, at 70.

<sup>159</sup> Ex. 67-D, Minder Direct, at 41-42; Department Brief, at 84.

<sup>160</sup> Ex. 67-D, Minder Direct, at 42; Department Brief, at 84.

<sup>161</sup> Ex. 67-D, Minder Direct, at 41; Department Brief, at 84.

customer-requested additional service lines, extension alterations, and meter relocations.<sup>162</sup>

129. CenterPoint proposed tariff changes as part of this proceeding to reflect the rate modifications involved in this matter.<sup>163</sup> The Department agreed with CenterPoint's proposed changes, except for those changes needed to reflect rate design modifications.<sup>164</sup> At the hearing, CenterPoint agreed with the Department's proposals regarding tariffs.<sup>165</sup>

130. The agreed-to tariff changes are reasonable and should be adopted. CenterPoint has not demonstrated that discontinuing the winter construction reporting is needed. The Department's specific proposals for additional tariff language and reporting are reasonable.<sup>166</sup>

### **Operating Expenses**

131. Part of the rate determination is establishing an appropriate forecast of CenterPoint's operating expenses for the test year. The parties differed on the levels of certain expenses, mostly based on the differences in methodology used to calculate those expenses.

### **Rate Case Expenses**

132. CenterPoint identified rate case expenses that it would incur in this matter, including consultant and outside legal fees, administrative costs, and billings from the administrative law judge, the Department of Commerce and the Public Utilities Commission. The estimate for those expenses is \$1,182,275. CenterPoint did not allocate any of these expenses to its nonregulated business units. CenterPoint proposed that its expenses for this rate matter be recovered over a two-year period. CenterPoint also seeks to include the unrecovered costs from the **2004 Rate Matter**, estimated at \$554,167, over a two-year period.<sup>167</sup>

133. The Department asserted prior rate case expenses are not recoverable. Regarding the current matter, the Department asserts that the total amount should be reduced to the previous rate case costs plus inflation, and that the allowable expenses be amortized over a four-year period. These adjustments result in a reduction of the test year expenses by \$191,710.<sup>168</sup> the Department also maintains that a portion of the rate case expense should be allocated to CenterPoint's nonregulated operations.

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<sup>162</sup> Ex. 69, Minder Surrebuttal, at 15; Department Brief, at 85.

<sup>163</sup> Ex. 67-A, Minder Direct, at 43, Ex. 67-C, Minder Direct, BJM-23.

<sup>164</sup> Department Brief, at 85-86.

<sup>165</sup> Hearing Tr. Vol. 2, at 152.

<sup>166</sup> Ex. 69, Minder Surrebuttal, at 15; Department Brief, at 85.

<sup>167</sup> Ex. 31, Nesvig Direct, at 68-69, Schedule 22.

<sup>168</sup> Ex. 62, St. Pierre Surrebuttal, at 2.

134. CenterPoint withdrew its request for unrecovered costs from the **2004 Rate Matter**.<sup>169</sup> While continuing to maintain that no allocation to nonregulated business operations was required, CenterPoint maintained that 4% would be an appropriate amount if such allocation were deemed necessary, based on a weighted average of recent natural gas rate matters.<sup>170</sup> The Department's proposed adjustment to the **2004 Rate Matter** level of expenses (plus inflation) was opposed as unsupported.

135. The **2004 Rate Matter** was resolved by settlement. That outcome reduced overall expenses for that proceeding. Very few issues were agreed to in this proceeding. The rate case expenses can be reasonably expected to be higher in this proceeding. The higher amount is properly included as expenses. Those expenses must be allocated between regulated and nonregulated operations, however. Of all the other rate matters surveyed, the most similar is **Great Plains**. In that matter, the general allocator of 17.8% was applied since no direct identification of costs was possible and significant issues were addressed regarding the interplay of regulated and nonregulated business units in that matter.<sup>171</sup> Application of CenterPoint's general allocator of 27.3% in this matter is appropriate by those standards and the claimed rate case expense should be reduced by \$270,424, which is the amount properly assigned to nonregulated business operations.<sup>172</sup>

136. CenterPoint proposed a two-year amortization period for the rate case expenses incurred in this proceeding. The two-year period was based on CenterPoint's estimate of when it will next be filing for a rate adjustment. The Department recommended a four-year amortization period, based on the average period between rate filings, going back to 1977. The same average is obtained using CenterPoint's rate filings from 1993 onward.<sup>173</sup>

137. Amortizing rate case expenses is appropriate since they are expenses that will not be incurred in each year on a going-forward basis. CenterPoint's proposal for a two-year amortization period is supported only by the opinion of its witnesses regarding possible future rate filing. The record in this matter contains several significant changes in CenterPoint's financial situation that prompted this rate matter. Those significant changes are unlikely to be repeated in the near term. Under these circumstances, the Department's average period between rate filings, four years, is the appropriate figure for amortizing rate case expenses.

### **Conservation Improvement Program**

138. CenterPoint operates Conservation Improvement Program/Demand Side Management projects (CIP) as part of its efforts to improve customer conservation. CIP is submitted biennially to the Department for consideration and approval by the

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<sup>169</sup> Had the request not been withdrawn, the ALJ would have recommended that the request be denied, consistent with the Commission's recent decision in **Great Plains**.

<sup>170</sup> Ex. 32A, Nesvig Rebuttal, at 8, Schedule 2.

<sup>171</sup> **Great Plains**, ALJ Findings at 39-40.

<sup>172</sup> Ex. 61, St. Pierre Direct, at 23.

<sup>173</sup> Department Brief, at 44-45.

Commissioner of Commerce. CenterPoint's CIP for 2005-2006 was approved on November 30, 2004.<sup>174</sup> The Department recommended accepting the approved CIP.<sup>175</sup>

139. Costs to the CIP program are recovered by utilities through a conservation cost recovery charge ("CCRC"). The costs incurred in CIP projects, less the revenue obtained through the CCRC, are netted out through the CIP tracker balance. In each rate case, CenterPoint "trues up" its CIP tracker account balance. CenterPoint also proposed amortizing the tracker account balance over a two-year period, to be consistent with CenterPoint's anticipated filing of its next rate matter.<sup>176</sup>

140. The Department accepted the tracker balance and proposed test year expenses, but initially objected to the restatement of the tracker balance, whereby CenterPoint applied the finally approved adjustment to the CCRC over the interim rate period. The Department withdrew its objection after it acknowledged that CenterPoint's restatement results in a refund of \$388,652 to ratepayers.<sup>177</sup>

141. The Department continued to object to CenterPoint's proposed recovery of expenses by amortizing the tracker balance over two years. The Department maintained that a four-year amortization period was the correct approach.<sup>178</sup>

142. The Department also maintained that CIP expenses should be allocated across customer classes by throughput. The throughput method was adopted in five recent gas rate cases. The Department also recommended that all Minnesota ratepayers be treated equally by allocating the CIP costs among rate classes on a volumetric basis.<sup>179</sup>

143. The simplest method for account recovery, offsetting the CIP tracker account balance against any interim rate refund required in this matter, is the appropriate means of truing up that balance. Any remaining balance should be amortized over a four-year period, consistent with the rate case expense amortization period. The benefits of conservation are experienced across all rate classes. Reflecting this benefit, CIP costs should be allocated among rate classes on a volumetric basis.

### **Income Tax – Interest Synchronization**

144. CenterPoint used interest synchronization in its calculation of income taxes. The Department recommends reflecting the income tax effects of the Department's adjustments and using the interest synchronization method for income tax

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<sup>174</sup> *In the Matter of the Implementation of the CenterPoint Energy Minnegasco 2005-2006 Biennial Natural Gas Conservation Improvement Program*, Commerce Docket No. G-008/CIP-04-821 (Deputy Commissioner Decision issued November 30, 2004).

<sup>175</sup> Ex. 67A, Minder Direct, at 3; Department Brief, at 77-78.

<sup>176</sup> CenterPoint Brief, at 98.

<sup>177</sup> Ex. 69, Minder Surrebuttal, at 6; Department Brief, at 79-80.

<sup>178</sup> Department Brief, at 81.

<sup>179</sup> Ex. 67A Minder Direct, at 12-14; Department Brief, at 81-82.

purposes. With the adoption of the Department's revenue requirement calculation, the tax expense amount is increased by \$344,000.<sup>180</sup>

### **Gross Revenue Deficiency**

145. As discussed in foregoing findings, CenterPoint calculated a gross revenue deficiency of \$40.879 million. The Department calculated two alternative gross revenue deficiencies: Alternative 1 (based on the 7.42% ROR) was a deficiency of \$21.575 million, and Alternative 2 (based on a 7.74% ROR) was a deficiency of \$24.934 million.<sup>181</sup> Should the Commission accept the recommended 7.42% ROR, CenterPoint's appropriate gross revenue deficiency is \$21.575 million, further adjusted by the other changes to the rate base in this matter.

### **Corporate Costs – Regulated and Unregulated**

146. CenterPoint operates both regulated and nonregulated businesses. CenterPoint's operating costs must be allocated between these businesses to ensure that rates are determined only by costs incurred by regulated business operations. By prior Commission Order, CenterPoint has incorporated allocation methods into a Cost Allocation Manual (CAM) that governs the division of expenses between regulated, nonregulated, and capital accounts.<sup>182</sup>

147. CenterPoint calculated the test year general allocation factor used to derive CenterPoint's regulated business revenue requirement by adjusting the 2004 regulated/non-regulated general allocation ratio. The Department noted that the adjustment reflected only some of the planned and projected changes in CenterPoint's Minnesota operations. The Department maintained that failure to include all projected changes to both the regulated and nonregulated operations results in an unsupported allocation factor.<sup>183</sup> The Department calculated an alternative general allocation factor based on CenterPoint's total projected expenses included in the 2006 plan year, using the information provided by CenterPoint (in response to DOC IR 109).

148. Based on its calculation, the Department recommended an adjustment of \$368,767 to the claimed corporate costs. This amount is the difference between the generally allocated expenses included in CenterPoint's proposed revenue requirement and the amount that would have been allocated to regulated operations using the factor calculated by the Department.<sup>184</sup>

149. In response, CenterPoint recalculated its general allocation factor and arrived at revised general allocator of 72.52 percent versus the filed calculation of 72.75

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<sup>180</sup> Ex. 61, St. Pierre Direct, at 34, MAS-7.

<sup>181</sup> Department Brief, at 86, and Attachment 2.

<sup>182</sup> See e.g. Ex. 31, Nesvig Direct, Schedule 24.

<sup>183</sup> Ex. 66, Bender Surrebuttal, at 11.

<sup>184</sup> Ex. 64, Bender Direct, at 15, SB-4.

percent. By CenterPoint's calculation, using the new allocation factor reduces the test year expense by \$26,602 from the original submission.<sup>185</sup>

150. CenterPoint and the Department agreed that the initially proposed general allocation factor of 72.75 percent should be revised to 72.52 percent.<sup>186</sup> But the Department questioned additional adjustments to determine projected 2006 operating expenses for CenterPoint's consolidated regulated/nonregulated operations. The Department surmised that the projected 2006 operating expenses were already reflected in CenterPoint's response to Department IR 109(B) and used by the Department in its calculation.<sup>187</sup>

151. The Department conducted further analysis on the additional information provided by CenterPoint to support the proposed allocation of corporate costs. The Department concluded that the information was insufficiently detailed to confirm CenterPoint's proposed allocation factor.<sup>188</sup> The record supports the test year general allocation factor determined by the Department, and a resulting test year adjustment of \$368,767 as calculated by the Department.<sup>189</sup>

152. The Department also demonstrated that CenterPoint improperly allocated legal expenses between the regulated and unregulated business operations of CenterPoint. The Department's analysis included adjustments to provide proper allocation between those business operations. An additional adjustment of \$186,132 for improperly allocated legal expenses has been demonstrated to be appropriate.<sup>190</sup>

### **Corporate Costs – Allocations from CNP**

153. CenterPoint receives services from its parent corporation, CNP, which are included in the expenses that form part of CenterPoint's rate calculation. CNP maintains a corporate "general ledger" where the costs of certain centralized corporate activities are recorded. These corporate costs are then billed out to CNP's various business units, including the Company, through a detailed methodology that has been reviewed, discussed, and generally agreed upon with regulators over the past many years. Under this methodology, the first step is for each department to directly bill the costs of providing its services to specific users wherever possible ("direct billing"). When direct billing is not practical, costs are assigned using cost-causation principles, following the principles established by the National Association of Regulatory Utility Commissioners ("NARUC") "guidelines for cost allocations and affiliate transactions."<sup>191</sup>

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<sup>185</sup> Ex. 32A, Nesvig Rebuttal, at 24.

<sup>186</sup> CenterPoint Brief, at 93.

<sup>187</sup> See Ex. 64, Bender Direct, SB-4.

<sup>188</sup> Ex. 66, Bender Surrebuttal, at 7-9.

<sup>189</sup> Ex. 64, Bender Direct, at 15-16, SB-4, and SB-5. The allocation factor was designated trade secret and for that reason, the factor is not identified here.

<sup>190</sup> Ex. 64, Bender Direct, at 13-14. The allocation methods and corrections were designated trade secret and for that reason, that information is not identified here.

<sup>191</sup> See Ex. 31, Nesvig Direct, at 49-52.

The primary areas to which costs are allocated by CNP are Executive, Finance, Communications, Legal, and Human Resources.<sup>192</sup>

154. CNP's methodology was reviewed and assessed by a consulting firm. One part of the corporate allocation work performed by CNP utilizes the Composite Ratio Formula, developed at the specific request of staff of the Securities Exchange Commission ("SEC"). SEC staff audited CNP's allocations in 2005 and proposed no changes to this formula. CenterPoint indicated that CNP's corporate allocations applicable to CenterPoint's Minnesota gas operations in 2005 are approximately \$2 million higher than in the base year 2004. CenterPoint attributed approximately \$1.2 million of the increase to CNP's allocation of fixed costs among fewer business units after the sale of CNP's Texas Genco business unit at the end of 2004. An additional \$300,000 was attributed to an increase in audit department costs, largely resulting from increased staff and higher audit fees resulting from increased auditing activity driven by the Sarbanes-Oxley Act.<sup>193</sup> CenterPoint also cited its addition of an environmental compliance function that benefits all CNP's units, including CenterPoint.<sup>194</sup>

155. The Department objected to the increased level of corporate cost assigned to CenterPoint by CNP. The Department analyzed the CNP cost categories and the amounts allocated to each. Increases in the amounts for certain categories and the addition of items within categories were noted by the Department as needing justification.<sup>195</sup> These costs, the Department maintains, are not supported as to amount or reasonableness.<sup>196</sup>

156. CenterPoint objected to the Department's approach, stating:

There are several reasons why this method is not appropriate. First, this method does not take into account two years of inflation. Second, this method does not take into account expenses incurred in one cost center in 2004 and planned in another cost center in 2006. For example, Ms. Bender points out that 'Pres and CEO' allocable costs increased dramatically from 2004 to 2006. However, a significant portion of the increase is due to costs that were incurred in the 'process improvement' and 'gas group president' centers in 2004 but are budgeted in the president and CEO cost center in 2006. The process improvement and gas group president cost centers show a reduction of almost \$1 million between 2004 and 2006. Another example is work that was done at Minnesota Gas in 2004 and is planned at corporate in 2006. The internal audit function at Minnesota Gas was transferred to corporate at the end of 2004. Some human resources activities were also transferred to corporate. Those

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<sup>192</sup> Ex. 31, Nesvig Direct, at 52

<sup>193</sup> See Ex. 31, Nesvig Direct, at 49-52. The Sarbanes-Oxley Act of 2002 is Pub. L. No. 107-204, 116 Stat. 745 (July 30, 2002),

<sup>194</sup> Ex. 32A, Nesvig Rebuttal, at 19-20.

<sup>195</sup> Ex. 64, Bender Direct, at 4.

<sup>196</sup> Ex. 66, Bender Surrebuttal, at 6; Department Brief, at 48.

transfers are reflected in a reduction to Minnesota Gas operating expenses in the Complement adjustment.<sup>197</sup>

157. As an alternative, CenterPoint proposed that these costs be calculated by establishing a baseline of demonstrated corporate costs from 2004, factoring in inflation, and adding known and measurable changes to that figure. The resulting amount would be applied to CenterPoint using the 2006 allocation factors.<sup>198</sup> The total allocation under this alternative approach is \$9.51 million.<sup>199</sup> The Department noted that this alternative approach would not recognize reductions in costs that should have occurred when the Texas Genco business unit was sold.<sup>200</sup>

158. CenterPoint provided additional information about the CNP allocations from 2004 and 2006. But this information was not broken out into the same categories. The 2006 totals come from the five areas identified above (Executive, Finance, Communications, Legal, and Human Resources), while the 2004 totals are broken out into those five and two additional areas (IT and Shared Services). There is no information regarding how those costs are treated in the calculation.

159. CenterPoint adopted a new accounting system on January 1, 2004. The financial information CenterPoint relies on in this rate matter was presented in the format of the prior accounting system. The Department noted that this transition has made classification of particular costs difficult.<sup>201</sup> In addition, particular costs appear to be unsupported in the workpapers developed by CenterPoint in making its cost allocations. Upon analyzing the spreadsheets used to support the allocations, the Department noted that the costs were not identified in sufficient detail to verify the allocation. The Department also noted another significant irregularity reflected in the transactions on the spreadsheets.<sup>202</sup> The Department proposed that the Commission order CenterPoint to provide a base year reconciliation with the proposed adjustments and test year information in CenterPoint's next rate case.<sup>203</sup>

160. CenterPoint described certain increases as "known and measurable changes," which include the transfer of various functions and initiation of new corporate functions. The total of these changes is an increase in costs of approximately \$740,000.<sup>204</sup>

161. CenterPoint asserted that the Department's approach was merely a "pick and choose" approach to test year corporate costs. CenterPoint maintained that criticism of these expenses requires an examination of the 2006 proposed corporate expenses to determine whether or not those expenses are reasonable, CenterPoint maintained that the Department was merely comparing 2004 corporate expenses with

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<sup>197</sup> Ex. 32, Nesvig Rebuttal, at 18-19.

<sup>198</sup> Ex. 32A, Nesvig Rebuttal, 20-21

<sup>199</sup> Ex. 32A, Nesvig Rebuttal, Schedule 8, at 1.

<sup>200</sup> Department Brief, at 50.

<sup>201</sup> Ex. 66, Bender Surrebuttal, at 9-10.

<sup>202</sup> Ex. 66, Bender Surrebuttal, at 8.

<sup>203</sup> Ex. 66, Bender Surrebuttal, at 8.

<sup>204</sup> Ex. 32A, Nesvig Rebuttal, Schedule 8, at 1.



2006 corporate expenses in those same categories, and selecting the lower number, regardless of year.<sup>205</sup>

162. The Department responded that its approach was to determine what costs, if any, could be established and shown to be reasonable. The Department's analysis of CenterPoint's information concluded that a cost was justified if any support was provided for that cost. The 2004 costs were only used when the alternative was for the Department to recommend no recovery of that cost.<sup>206</sup> The Department demonstrated that its comparison of 2004 to 2006 was comprehensive. The Department's approach results in supported and reasonable costs being included in the rate determination.

163. The Department's analysis supports a reduction of \$2,080,683 for corporate expenses.

### **Pension Benefits**

164. CenterPoint requested a test year pension expense of \$1.6 million before allocation between regulated and non-regulated operations. The base year pension expense was \$6.1 million. This reduction in test year pension expense primarily arose from a large contribution made to the pension fund by CenterPoint at the end of 2004. Other factors in the expense reduction were increased by expected earnings on pension fund assets and reduced amortization of previously unrecognized losses. CenterPoint relied upon an actuarial analysis using CenterPoint's participant demographics and actuarial assumptions used by CNP (which actually administers CenterPoint's pension fund), in arriving at its pension expense figure.<sup>207</sup>

165. The Department recommended that the pension benefit expense be adjusted by levelizing the expense to the four-year average of funding levels (over the period from 2001 to 2004). The Department maintained that CenterPoint's past levels of pension funding have not matched the level of expense built into rates since 1994.<sup>208</sup>

166. CenterPoint maintains that the Department is engaged in impermissible single issue and retroactive ratemaking. Using the same levelizing approach with other post employment benefits results in higher rates of recovery.<sup>209</sup> CenterPoint also claimed that the pension period used for averaging deliberately excluded the 2005 pension expense, which would increase the recoverable expense.

167. The Department responded that the other pension items were not sufficiently large to warrant attention. The averaging period used was the period for which CenterPoint made information available. The 2005 information was not provided in time for the Department to analyze the data. CenterPoint itself changed the pension benefit analysis by making a large voluntary contribution to the pension fund at the end

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<sup>205</sup> CenterPoint Brief, at 89.

<sup>206</sup> Department Reply Brief, at 40-41

<sup>207</sup> Ex. 32A, Nesvig Rebuttal, at 2-3.

<sup>208</sup> Ex. 62, St. Pierre Surrebuttal, at 22.

<sup>209</sup> See Hearing Tr. Vol. 3, at 129-130 (St. Pierre).

of 2004. The result was a large reduction in test year pension expense compared to the 2004 base year amount. The actuarial assumptions used for the test year may differ materially from actual results due to CenterPoint's contributions.<sup>210</sup>

168. In a recent rate matter, the Commission levelized the pension expense over five years and stated:

Levelizing is standard ratemaking treatment of anomalies in test year expenses, and the possibility that the timing of the Company's next rate case may work to its disadvantage in regard to this one test year expense does not justify abandoning normal test year procedures for dollar-for-dollar recovery.<sup>211</sup>

169. In this matter, the Department has shown that CenterPoint's recent pension expenses are anomalous and that an actuarial forecast is not consistent with the past experience in pension funding. Under these circumstances, the levelizing approach from the 2004 IPL Order is appropriate to determine the pension rate expense. The Department's approach reduces CenterPoint's test-year general and administrative expense by \$220,797.<sup>212</sup>

### **Bad Debt Expenses**

170. CenterPoint proposed calculating a test-year bad debt expense by taking the actual 12-month period (ending June 30, 2005) bad debt expense as a percentage of firm revenue for that period. The resulting percentage, calculated to be 1.37%, was identified as the bad debt factor to be applied to the test year firm revenue to derive the appropriate bad debt expense figure.<sup>213</sup> CenterPoint noted that the actual bad debt factor for the 12-month period ending December 31, 2005 had risen to 1.42%.<sup>214</sup>

171. The Department recommended linking the bad debt expense to the rate case revenue requirement, thereby decreasing the Customer Service and Information expense by \$1,027,822.<sup>215</sup> The Department concluded that a bad debt factor of 1.37% was reasonable and actual bad debt expenses in the test year would not be overstated using that figure.<sup>216</sup>

172. CenterPoint and Energy CENTS entered into a Stipulation addressing three issues: (1) an affordability program (discussed with rate design issues below); (2) bad debt recovery; and (3) PGA recovery of the gas cost portion of its bad debts

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<sup>210</sup> Hearing Tr., Vol. 3 at 131-32.

<sup>211</sup> *ITMO a Petition by Interstate Power and Light Company for Authority to Increase Electric Rates in Minnesota*, PUC Docket No. E-001/GR-03-767, at 25 (Commission Findings of Fact, Conclusions of Law, and Order Modifying Settlement issued April 5, 2004)(**"2004 IPL Order"**).

<sup>212</sup> Ex. 61, St. Pierre Direct, at 29; Department Brief, at 59.

<sup>213</sup> Ex. 4, Nesvig Workpapers, Vol 1, Schedule 6, Workpaper 4; Department Brief, at 61-62.

<sup>214</sup> Ex. 32, Nesvig Rebuttal, at 13, Schedule 5.

<sup>215</sup> Department Brief, at 61-62.

<sup>216</sup> Ex. 61, St. Pierre Direct, at 5.

(discussed in Findings below). As part of this Stipulation, CenterPoint adjusted its bad debt factor to 1.27% and withdrew the PGA cost recovery proposal.<sup>217</sup>

173. The lower bad debt factor was derived from averaging the actual bad debt percentages over the past two calendar years (2004 and 2005). The OAG expressed concern that the resulting percentage did not adequately account for the ameliorative effect of the Affordability Program and federal and state assistance programs. CenterPoint responded that the Affordability Program expressly includes:

[A] financial evaluation including, the total net savings including cost reductions on utility functions such as the impact of the Program on write-offs, service disconnections and reconnections and collection activities. . . . [A]ny net benefit after the initial four-year term of the Program will be added to the Tracker for refund to residential ratepayers.<sup>218</sup>

174. The terms of the Affordability Program, including the financial evaluation and tracker adjustment, address the concerns of the OAG regarding potential over-recovery of bad debt costs. The agreement to use a bad debt factor of 1.27% is supported by the record and is unlikely to result in the excessive retention of funds in the bad debt reserve that a higher percentage could generate. The terms of the Affordability Program preclude any harm to residential ratepayers. Use of the 1.27% bad debt factor has been shown to be appropriate.

### **Fleet Expenses**

175. CenterPoint's initial filing included a "fleet adjustment" reflecting an increase in the per gallon cost of gasoline between the base year and the test year. The adjustment also reflects an increase in miles driven. No party challenged the increase in miles driven.

176. CenterPoint noted in its initial filing that the average price per gallon of gasoline for the base year 2004 was \$1.74 per gallon.<sup>219</sup> The increase in gasoline prices in 2005, to over \$3.00 per gallon at some locations, was also noted. CenterPoint projected gasoline to cost \$2.56 per gallon over the test year, based on the average Minnesota price for regular gasoline on August 29 as published by the Energy Information Administration of the U.S. Department of Energy ("EIA"). CenterPoint projected its test year price assuming gasoline prices would remain consistent with average prices published for Minnesota at the end of August 2005.<sup>220</sup>

177. The Department objected to CenterPoint's use of the price of gasoline on one single day to determine the reasonable cost of gasoline for the test year. The Department noted that the January and February gasoline prices averaged 89 percent lower than the average for the entire year for 2002 through 2005 due to seasonality of

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<sup>217</sup> Ex. 17.

<sup>218</sup> Ex. 171, Draft Gas Affordability Service Program Tariff, Section 5.3.

<sup>219</sup> Ex. 31, Nesvig Direct, at 25.

<sup>220</sup> Ex. 31, Nesvig Direct, at 25.

gasoline demand.<sup>221</sup> The Department maintained that seasonal fluctuations and the historic January/February prices from 2002 through 2005 averaging 89 percent of the average price for the year required use of a lower figure for the cost of gasoline. Based on the EIA's projected average of \$2.42 per gallon for 2006, the Department increased its recommended cost of gasoline from \$2.21 to \$2.46 per gallon.<sup>222</sup> Energy CENTS recommended using the 2005 weekly average price as the test year price.

178. CenterPoint has demonstrated that the price of gasoline for the test year is likely to exceed the forecasted levels when using the Department's methodology. Put another way, the usual forecasting methodology results in an anomalous result. Under such limited circumstances, the use of a benchmark high price within the forecast period is sufficient support for determining the price in the test year. Fleet expenses should be calculated using the \$2.56 per gallon projected gasoline cost over the test year,

### **Claims Expenses**

179. CenterPoint has been self-insured for more than 15 years for automobile and general insurance claims. This self-insurance covers up to \$1 million on general liability claims for 2004, 2005 and 2006.<sup>223</sup> Other insurance is maintained by CenterPoint for claims above that amount.<sup>224</sup> As part of its filing, CenterPoint included expenses related to general liability and auto claims. CenterPoint used a three-year average of actual claims activity attributable to regulated operations from January of 2002 through December of 2004 to determine this expense. The test-year claims expense totals \$728,347 (\$79,589 for auto, \$499,875 for litigation, and \$148,883 for general claims) before adding inflation of \$9,147.<sup>225</sup> The three-year average was used to "smooth out" the results, since the size of claims can vary significantly from year to year.

180. The Department recommended that the claims expense be normalized or levelized over a four-year period, consistent with other Department amortizations recommended in other rate case adjustments. A four-year period, the Department maintains, will more fairly normalize these expenses for purposes of rates. Using the historical claims expense for CenterPoint from 2001 through 2004 totals \$2,345,279.<sup>226</sup> Dividing that amount by four years results in an average of \$586,320. Subtracting this average from the Company's proposed \$728,347 results in a decrease of \$142,027. Accordingly, inflation would also be reduced by \$6,065 for a total adjustment of \$148,092.<sup>227</sup> The Department's recommendation decreases general and administrative expenses by \$148,092.<sup>228</sup>

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<sup>221</sup> See Ex. 32A, Nesvig Rebuttal at 11.

<sup>222</sup> Ex. 62, St. Pierre Surrebuttal at 25; Ex. 32, Nesvig Rebuttal, at 11.

<sup>223</sup> Ex. 61, St. Pierre Direct, MAS-18.

<sup>224</sup> Ex. 61, St. Pierre Direct, at 29-30.

<sup>225</sup> Ex. 61, St. Pierre Direct, at 30.

<sup>226</sup> Ex. 61, St. Pierre Direct, at 30-31.

<sup>227</sup> Ex. 61, St. Pierre Direct, at 30-31.

<sup>228</sup> Ex. 61, St. Pierre Direct, at 31.

181. CenterPoint responded to the Department's suggestion by adding the actual expense numbers for 2005. The Department objected to using 2005 data for the four-year analysis, maintaining that using that year would be inconsistent with the Department's approach on pension expenses, where data from 2001-2004 was used to calculate the Department's position.<sup>229</sup>

182. The Department has not demonstrated any linkage between pension expenses and claims expenses. The averaging is used to ensure that the test year's costs are not unduly influenced by peaks or valleys in recent expenses. Absent the sort of unusual situation posed by the pension situation, including the most recent available data is appropriate for determining the average. The Department advocated for updating the rate base to actual 2005 numbers and the reasoning for doing so applies equally to the claims expense. CenterPoint's four-year average should be adopted for determining the test-year claims expense.

### **Advertising Expenses**

183. CenterPoint identified expenses of \$1,047,794 for general and informational advertisements.<sup>230</sup> The Department disputed whether the content of four specific advertising promotions met the statutorily-established categories authorizing inclusion in the rate base.<sup>231</sup> The identified programs were, in the Department's view, directed at promoting additional gas consumption, promoting goodwill, and enhancing CenterPoint's image. These are not allowable advertising expenses under Minn. Stat. § 216B.16, subd. 8(a)(4), and the Department proposed reducing the claimed expenses by \$7,568 to reflect those disallowed expenses.<sup>232</sup> At the evidentiary hearing, CenterPoint agreed to that adjustment.<sup>233</sup> The effect of the change is to decrease the allowable advertising expense by \$7,568 to \$1,040,236.<sup>234</sup>

### **GTI Research and Development**

184. As part of the **2004 CenterPoint Rate Matter**, CenterPoint and the Department agreed that \$250,000 in research and development expenses for the Gas Technology Institute (GTI) would be allowed. GTI is a not-for-profit corporation located in Illinois which provides, among other services, contract research.<sup>235</sup> This agreement was predicated on CenterPoint making available the results of any projects, the potential applications of those projects, and accounting for funding of any projects initiated.<sup>236</sup> The Commission approved the expense as part of the **2004 CenterPoint Rate Matter**.<sup>237</sup>

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<sup>229</sup> Ex. 62, St. Pierre Surrebuttall, at 23.

<sup>230</sup> Ex. 31 Nesvig Direct, at 44; Ex. 67-A Minder Direct, at 31.

<sup>231</sup> Department Brief, at 73-74 (citing Minn. Stat. § 216B.16, subd. 8).

<sup>232</sup> *Id.*

<sup>233</sup> Hearing Tr. Vol. 2, at 152.

<sup>234</sup> Ex. 44, Vol. 1, at 27.

<sup>235</sup> Ex. 67-A, Minder Direct, at 38.

<sup>236</sup> Department Brief at 75.

<sup>237</sup> Hearing Tr. Vol. 2, at 155.

185. CenterPoint has proposed \$250,000 in GTI research and development expenses in the test year for this proceeding.<sup>238</sup> The Department noted that there have been no funded GTI projects since the Commission approval of the rates in the **2004 CenterPoint Rate Matter**.<sup>239</sup> With the lack of projects actually funded, the Department suggested that additional monitoring of the projects and their associated costs would be appropriate.<sup>240</sup>

186. In response, CenterPoint agreed that GTI projects would be open for inspection and that accounting would be provided for each funded GTI project. CenterPoint also proposed to establish a separate liability account to which the expense dollars would be applied.<sup>241</sup> The Department agreed with the liability account approach and recommended that its starting balance equal all revenues collected from ratepayers for GTI project funding from the implementation of interim rates in this ratemaking. The Department also recommended annual compliance filings on the account, detailing revenues and GTI expenses over the prior period.<sup>242</sup>

187. The compliance filings would be used to show what money had been applied each month at the level approved by the Commission and show actual expenditures debited to the account at the time payments are made.<sup>243</sup> CenterPoint also agreed that the account would be subject to true up at the time of its next rate case. Any unexpended balance would be returned to customers. The Department recommended that the Commission clarify the true-up provision to limit the changes to refunding to customers, not increasing the account balance in the event CenterPoint expends more than the \$250,000 annual expense approved for GTI research. The Department also requested clarification that the cap of \$250,000 applies separately to each year, and that such expenditures are not netted across years in the true-up process.<sup>244</sup>

188. The proposed \$250,000 in GTI research and development expenses in the test year are reasonable costs. Establishing a separate liability account for these expenses is appropriate. The account starting balance should equal all revenues collected from ratepayers for GTI project funding from the implementation of interim rates in this ratemaking. CenterPoint should submit annual compliance filings on the account, detailing revenues and GTI expenses over the prior period. The annual expenses for research and development should not to be carried over from year-to-year.

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<sup>238</sup> Ex. 31 Nesvig Direct, at 29-30.

<sup>239</sup> Hearing Tr. Vol. 2, at 155.

<sup>240</sup> Ex. 67-A, Minder Direct, at 42.

<sup>241</sup> Ex. 32 Nesvig Rebuttal, at 25-26.

<sup>242</sup> Department Brief, at 76-77.

<sup>243</sup> See CenterPoint Brief, at 102-03.

<sup>244</sup> Department Reply Brief, at 29-30.

### **Bad Debt Recovery of Natural Gas Costs**

189. The existing mechanism for bad debt recovery is to build into rates an expense for uncollectible accounts. CenterPoint identified the increased impact of bad debt costs as a substantial financial cause of this rate proceeding. To address the problem, CenterPoint initially proposed to recover the gas cost portion of its bad debt through the purchased gas adjustment (PGA). This would transfer responsibility for the portion of the bad debt expense that is comprised of the cost of natural gas directly to customers. As an alternative, CenterPoint proposed creation of a tracking account to determine the amounts that constitute the gas portion of the bad debt expense and allow for future recovery of amounts not covered by rates.<sup>245</sup>

190. The Department objected to the proposed changes in bad debt cost recovery. Specifically, the Department cites Minn. Stat. § 216B.16, subd. 7, which states:

Notwithstanding any other provision of this chapter, the commission may permit a public utility to file rate schedules containing provisions for the automatic adjustment of charges for public utility service in direct relation to changes in: (1) federally regulated wholesale rates for energy delivered through interstate facilities; (2) direct costs for natural gas delivered; or (3) costs for fuel used in generation of electricity or the manufacture of gas.

191. The charge proposed by CenterPoint for inclusion in the PGA is not the “direct cost of gas” within the meaning of the statute. Rather, those charges are indirect, having come from the customer’s failure to pay. The appropriate mechanism for recovering bad debt expenses remains through the rates charged to customers, determined through the test year methodology. This issue was addressed by CenterPoint in its Stipulation with Energy CENTS, where the proposal to recover costs through the PGA was withdrawn.<sup>246</sup> Regardless of the stipulation, inclusion of the costs in the PGA would be inappropriate.

### **Affordability Program**

192. In its initial rate proposal, CenterPoint proposed establishing an affordability program to assist low income customers in meeting the increasingly high cost of natural gas.<sup>247</sup> In the course of the contested case proceeding, Energy Cents and CenterPoint arrived at an agreement regarding how the affordability program (“the program”) would be established, funded, and administered. Because the details of that program were not well established, additional testimony was prefiled and a further day of hearing was held on June 28, 2006 to establish a record regarding the program.

193. The program would have an annual budget of \$5 million and the costs would be charged solely to the residential class of ratepayers. Eligibility for the program

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<sup>245</sup> Ex. 12, Hammond Direct, at 30.

<sup>246</sup> Ex. 17.

<sup>247</sup> Ex. 12, Hammond Direct, at 26-28.

is determined by actual receipt of benefits from the Low Income Home Energy Assistance Project (LIHEAP). The program included an affordability component and an arrearage forgiveness component. The affordability component consists of a credit on the customer's bill that is one-twelfth the difference between the customer's estimated annual gas bill and 6% of the customer's household income.<sup>248</sup>

194. The arrearage forgiveness component consists of a credit to be applied each month after a customer's payment is received. The credit consists of an amount added to the customer's payment as a "co-pay" of a portion of the outstanding arrearages. The customer's overall arrearage amount would be apportioned for repayment over a period not to exceed 24 months.<sup>249</sup>

195. Participating customers who miss two consecutive payments may be terminated from the program. Customers who are terminated from the program may be disconnected from gas service, unless the cold weather rule applies. Customers who maintain their payments will not be disconnected, no matter how large their arrearages. Information concerning participation in the program will be mailed to customers who are 90 days or more in arrears.<sup>250</sup>

196. Under the stipulation, the total program cost shall not exceed \$5 million per year. That figure includes administrative costs, and CenterPoint pledged to make its best effort to contain those costs to less than 5% of the total program costs. Those costs are to be recovered through the volumetric charge applied solely to the residential class. The parties agreed that a tracking mechanism would be established at the initiation of the program to provide for the recovery of actual program costs. The program will have an initial four-year term, and CenterPoint will report annually to the Commission on the status of the program.<sup>251</sup>

197. Included in the Stipulation were changes to CenterPoint's proposed bad debt recovery. As discussed in foregoing Findings, CenterPoint's bad debt expense for this rate matter would be calculated by application of a 1.27% bad debt factor. As part of the Stipulation, CenterPoint also agreed to withdraw its proposal to recover the cost of unrecoverable gas through the purchased gas adjustment (PGA).<sup>252</sup>

198. OAG expressed concern that the development and administration costs could consume an excessive portion of the program's budget. The potential for one-time development costs of \$300,000 and administration costs of \$250,000 per year were cited as reasons to disapprove the stipulation regarding the program.<sup>253</sup>

199. The OAG objected to the use of tracking as the cost recovery mechanism as being outside the statutory authority of the Commission. OAG also objected to

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<sup>248</sup> Ex. 17.

<sup>249</sup> Ex. 17.

<sup>250</sup> Ex. 17.

<sup>251</sup> Ex. 17.

<sup>252</sup> Ex. 17.

<sup>253</sup> OAG Brief, at 73.



limiting the cost recovery to the Residential class of customers.<sup>254</sup> Deferred accounting was proposed as the means to determine how the program's costs should be allocated across customer classes.<sup>255</sup>

200. The program limits eligibility to customers who are recipients of LIHEAP assistance. OAG objected to this limitation as discriminatory towards customers who are LIHEAP-eligible, but do not receive that assistance due to budget limitations.<sup>256</sup> Energy CENTS cited the Xcel Energy electric affordability program as demonstrating that the limitation to existing LIHEAP recipients is an approved, nondiscriminatory method of administering the program. The statute setting out standards for such a program expressly limits benefits to "low-income customers" and states, "For the purposes of this subdivision, 'low-income' describes a customer who is receiving assistance from the federal low-income home energy assistance program."<sup>257</sup>

201. OAG proposed that the Commission open a separate docket to establish a state-wide affordability program, rather than approaching the subject in a "piecemeal" manner.<sup>258</sup> The legislation authorizing the Xcel program indicates that there is no compelling reason to delay instituting the affordability program over CenterPoint's large customer base in favor of a comprehensive program at some future date.

## **N. Rate Design**

### **Generally**

202. Setting reasonable rates requires attention to their design. Once a utility's revenue requirement is determined by the Commission, how that requirement will be met by increasing charges paid by customers must be established. Rate design is the application of revenue requirements to customer classes.

203. The issues to be addressed in rate design were recently summarized in the **Great Plains** ALJ Recommendation as follows:

The Commission's design of rates is a largely quasi-legislative function. The application of proportional distribution of the revenue requirement among customer classes involves policy decisions that are guided by fundamental principles of rate structure. The preference to eliminate cross-subsidization, for example, may be balanced against drastic changes in the cost of natural gas to particular rate classes. The Commission has used the following principles in its rate design decisions:

Rates should be designed to provide the Company a reasonable opportunity to recover all prudently incurred costs, including costs of attracting capital.

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<sup>254</sup> Ex. 118, at 8.

<sup>255</sup> OAG Brief, at 75.

<sup>256</sup> OAG Brief, at 75.

<sup>257</sup> Minn. Stat. § 216B.16, subd. 14.

<sup>258</sup> OAG Brief, at 75.

These rates, when matched to test-year customer counts and sales projections, should allow the Company a reasonable opportunity to collect its revenue requirement.

Rates should be designed to promote an efficient use of resources. As such, they should reflect the costs that classes of customers impose upon the system.

Rates and conditions of service should provide a reasonable continuity with the past. Rate-design changes should be reasonable and, to the extent possible, gradual to prevent drastic impacts on existing customers.

Rates should be understandable and easy to administer.<sup>259</sup>

### **Residential Basic Charge**

204. As in the **2004 Rate Matter**, CenterPoint has proposed an increase in the residential basic charge. CenterPoint's proposal would increase that charge from \$6.50 to \$8.00 per month. CenterPoint relies on its customer cost of service study (CCOSS) to support the increase. The CCOSS was performed with three different approaches. One was an overall study of embedded costs. The other two were specific to each of CenterPoint's two rate areas (Northern and Viking).<sup>260</sup>

205. The overall cost of service to residential ratepayers was determined to be \$20.47 by the CCOSS.<sup>261</sup> CenterPoint maintained that with an \$8.00 per month customer charge, it would recover roughly the same percentage of fixed costs from its residential customers as Xcel Energy currently recovers in its \$8 per month customer charge for residential electricity service.<sup>262</sup> The proposed change, CenterPoint maintains, is a continued slow movement toward the cost of service, which reduces intra-class subsidies, while imposing only a gradual increase in the overall costs paid by customers.

206. The Department noted that the three studies submitted by CenterPoint mostly followed the same approach as the CCOSS submitted in the **2004 Rate Matter**, which was part of the settlement approved by the Commission. The two differences noted were the separate accounting for transportation customers and moving the allocation of income tax to the rate base. The Department did not dispute any part of CenterPoint's CCOSS.<sup>263</sup> Energy CENTS disputed the tax allocation and that issue was addressed in a prior finding.

207. The Department's assessment of proper rate design is to gradually move the residential basic charge closer to actual costs incurred to serve that class of

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<sup>259</sup> **Great Plains**, ALJ Recommendation, Finding 160 (footnotes omitted).

<sup>260</sup> Ex. 12, Hammond Direct, at 17.

<sup>261</sup> Ex. 12, Hammond Direct, at 15, Schedule 8.

<sup>262</sup> CenterPoint Brief, at 121.

<sup>263</sup> Ex. 70, Bonnett Direct, at 22; Department Brief, at 89.

customer over time.<sup>264</sup> The Department asserts that CenterPoint's proposed increase of the monthly basic charge from \$6.50 to \$8.00 reduces interclass subsidies, reduces bill volatility between heating and nonheating seasons, and conforms the percentage of fixed costs to that awarded in a recent Xcel rate matter.<sup>265</sup>

208. OAG and Energy CENTS noted that the Commission explicitly refused to raise the residential basic charge to \$8.00 just one year ago.<sup>266</sup> Energy CENTS urged retention of the \$6.50 customer charge. OAG included the impact of the modified inverted block rate and asserted that CenterPoint's proposal amounted to a basic charge of \$9.63. This increase was opposed by OAG as excessive.<sup>267</sup>

209. The Commission ruled on the issue of increasing CenterPoint's residential basic charge just over one year ago. At that time, CenterPoint was seeking an increase from \$5.00 to an agreed-to level of \$8.00. That Commission analyzed the issue as follows:

In short, the commission finds that the advantages the \$8.00 customer charge might offer in terms of economic efficiency and revenue stability are more than offset by its adverse impact on low-income households, its tendency to neutralize conservation incentives in the minds of residential customers, and its potential to undermine customers' confidence in the reasonableness of the rate structure.

\* \* \*

The last time the company's customer charge was adjusted was in its 1992 rate case; since that time, the Consumer Price Index (CPI) has gone up by roughly 25%. While the 60% increase proposed in the settlement significantly exceeds inflation as measured by the CPI, the 30% increase represented by a \$6.50 customer charge does not.

Since permitting inflation adjustments to customer charges carries fewer risks than overhauling rate structures to rely on them more heavily, since customer charges do perform the helpful function of stabilizing utility revenue, and since the amount of money it issue – \$1.50 per month – is relatively small by almost any standard, the commission will permit the company to institute a new residential customer charge of \$6.50.<sup>268</sup>

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<sup>264</sup> Ex. 70, Bonnett Direct, at 23; Department Brief, at 89.

<sup>265</sup> ***In the Matter of an Application by Northern States Power Company d/b/a Xcel Energy for Authority to Increase Rates for Natural Gas Service in the State of Minnesota***, Docket No. G-002/GR-04-1511 (Order Accepting and Modifying Settlement and Requiring Compliance Filings issued August 11, 2005) ("**Xcel 2005 Rate Order**").

<sup>266</sup> OAG Brief, at 12; Energy CENTS Brief, at 35-36.

<sup>267</sup> OAG Brief, at 14, 21.

<sup>268</sup> ***2004 CenterPoint Rate Matter***, PUC Order, at 9 (Order Accepting and Modifying Settlement and Requiring Compliance Filing issued June 08, 2005).

210. The effect of CenterPoint's proposal is to phase-in an \$8.00 residential basic charge over two years (the first year being the \$6.50 basic charge approved by the Commission in 2005). Had the Commission thought such an approach to be appropriate, such a phase-in could have been adopted in that proceeding.

211. The Commission's rationale for approving the \$1.50 increase in 2005 clearly ties the appropriate increase to overall customer price increases. Since the increase was approved in June 2005, customer prices (as measured by the CPI) have increased by 4.3%.<sup>269</sup> Applying the Commission's customer price approach, an increase of \$0.28 to the basic residential charge would be appropriate. Anticipating the consistent rise in consumer prices and applying a reasonable forecast of the period before CenterPoint files for a new rate adjustment, an increase of \$0.50 to the basic residential charge is justified. Such an increase moves the rate incrementally closer to the cost of providing the service, conforms to the rate of increase in general consumer costs, and constitutes an objectively small increase in the basic charge.

212. Ensuring that the rate structure does not discourage conservation is another consideration in the approval of a particular rate design. An argument made throughout this proceeding is that increasing the residential basic charge acts as a disincentive to conservation. OAG and Energy Cents maintain that the proposed increase in the residential basic charge will discourage conservation. Both parties cite the statutory mandate that "to the maximum reasonable extent, the commission shall set rates to encourage energy conservation."<sup>270</sup>

213. CenterPoint responded that the interpretation of the statute urged by OAG and Energy CENTS would have prohibited all past Commission increases in customer charges, including its recent decision in the Xcel rate case, and taken to its extreme would require elimination of customer charges.<sup>271</sup> CenterPoint also noted that the entire delivery charge is significantly smaller than the wholesale charge portion of an average customer's bill.<sup>272</sup> CenterPoint maintains that proper pricing signals are the most important factor in customer decisions, including conservation, and that increasing the residential basic customer charge is important to accurate pricing.<sup>273</sup>

214. Adjustments to rate design must consider the impact on conservation. The Commission has held that sufficiently large increases can affect customer conservation.<sup>274</sup> Increasing the residential basic charge by \$0.50 will not have any impact on customer conservation efforts.

### **Basic Charge for Other Classes**

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<sup>269</sup> U.S. Department of Labor, Bureau of Labor Statistics, News (issued July 19, 2006) (<http://www.bls.gov/news.release/pdf/cpi.pdf>)

<sup>270</sup> Minn. Stat. § 216B.03.

<sup>271</sup> CenterPoint Brief, at 122.

<sup>272</sup> CenterPoint Brief, at 123.

<sup>273</sup> Ex. 13, Hammond Rebuttal, at 10; Hearing Tr. Vol. 1, at. 23-25.

<sup>274</sup> **2004 CenterPoint Rate Matter**, PUC Order, at 8 (Order Accepting and Modifying Settlement and Requiring Compliance Filing issued June 08, 2005).

215. CenterPoint did not propose any changes to the basic charge for any of the Commercial, Industrial, or Small Volume Dual Fuel classes from amounts set by the Commission in the **2004 Rate Matter**. The Department agreed with CenterPoint's position on these charges.<sup>275</sup>

216. The basic charge for Large Volume Dual Fuel customers was set at \$330 per month in the **2004 Rate Matter**. CenterPoint proposes to raise that basic charge to \$400 per month.<sup>276</sup> The Department expressed no objection to the proposed increase.<sup>277</sup> The basic charge increase to the LVDF customer class is reasonable.

### **Revenue Apportionment Between Classes**

217. A critical component of rate design is the division between rate classes of the increase in revenue needed to address the utility's demonstrated revenue deficiency. With an overall rate increase of approximately 2.4%, CenterPoint has proposed the following increases, apportioned by rate class.<sup>278</sup>

<b>Class</b>	<b>Total Revenue (including gas costs)</b>	<b>Not Including Gas Costs</b>
Residential	3.31%	21.45%
Comm. & Ind. A	3.32%	17.05%
Comm. & Ind. B	1.67%	11.62%
Comm. & Ind. C	1.65%	14.13%
Small Vol. Dual Fuel A	1.65%	18.36%
Small Vol. Dual Fuel B	1.65%	21.16%
Large Vol. Dual Fuel	0.10%	2.38%
Transportation	0.67%	0.67%

218. The Department maintained that this degree of movement in rates, while essentially eliminating any interclass subsidies, would result in rate shock for residential and some small business customers.<sup>279</sup> Using CenterPoint's CCOSS, the Department

<sup>275</sup> Ex. 70, Bonnett Direct, at 25; Department Brief, at 91.

<sup>276</sup> Ex. 12, Hammond Direct, at 25 (also increasing the basic charge for the Large General Service rate, which currently has no customers).

<sup>277</sup> Department Brief, at 91.

<sup>278</sup> Ex. 70, Bonnett Direct, at 14.

<sup>279</sup> Ex. 70, Bonnett Direct, at 15.

determined that all the Commercial and Industrial classes should experience the same rate increase to avoid rate shock for any individual class.<sup>280</sup> While this approach differs from the Department's position in the **2004 Rate Matter**, the change is based on the recent, unequal rate increases experienced by the Commercial and Industrial classes in 2005. The Department does not recommend the same approach for the Large Volume Dual Fuel class, since there is actual price competition for customers in this class.<sup>281</sup> The Department's proposed apportionment results in increases for the various customer classes as follows:<sup>282</sup>

<b>Class</b>	<b>Total Revenue (including gas costs)</b>	<b>Not Including Gas Costs</b>
Residential	2.69%	17.39%
Comm. & Ind. A	2.69%	13.76%
Comm. & Ind. B	2.69%	18.63%
Comm. & Ind. C	2.69%	22.95%
Small Vol. Dual Fuel A	2.69%	29.87%
Small Vol. Dual Fuel B	2.69%	34.44%
Large Vol. Dual Fuel	0.10%	2.38%
Transportation	0.67%	0.67%

219. The Department's approach means that revenue from the Residential and C/I A classes would cover 99.39% and 99.38% of those classes' cost of service, respectively. By contrast, the other classes (excepting LVDF and Transportation) would recover 100.99% to 101.02% of their classes' costs.<sup>283</sup> The Department maintains that its approach will have a less significant effect on customer rates, thereby reducing rate shock, and better adhere to the Commission's principles of rate design.

220. Some variation between classes is justified. The Commission could consider the rate shock that would occur if all cross-subsidization were eliminated at once. As noted by commentators, residential customers cannot pass on price increases. That class of customers is already experiencing the impact of increasing wholesale gas prices. The Department's proposed revenue apportionment is the best

<sup>280</sup> Ex. 70, Bonnett Direct, at 16.

<sup>281</sup> Ex. 70, Bonnett Direct, at 17.

<sup>282</sup> Ex. 70, Bonnett Direct, at 20.

<sup>283</sup> Ex. 70, Bonnett Direct, at 20.

option, considering the Commission's rate design principles. The only modification needed to the Department's proposal is to allocate the approved cost of the Affordability Program solely to the residential class. Since this cost will increase the impact of the rate increase on the residential customer class, it is further support for the Department's overall approach to revenue allocation.

### **Service Area Consolidation**

221. In the **2004 Rate Matter** settlement, CenterPoint and the Department agreed that the proposed merger of the Viking and Northern service areas would be limited to synchronizing the two areas' basic service charges and consolidating purchase gas adjustments (PGAs).<sup>284</sup> In this proceeding, CenterPoint has proposed to merge the two service areas into one, applying the same rates to all customers in their respective classes.<sup>285</sup>

222. The Department agreed in principle to the merger, but noted that the change in nongas rates results in an overall increase of 41% to Viking area customers. The average Viking area residential customer would experience a total annual bill increase of \$25.00 from the merger.<sup>286</sup> The Department maintained that such increases would necessarily result in rate shock to customers. The Department initially proposed phasing in the merger through three adjustments conducted over a period of three years. The first adjustment would be a movement by one-third toward full consolidation. That adjustment would occur twelve months after the Commission's order in this matter. The second and third adjustments would be in the same degree and on the same time table, resulting in full consolidation in three years. The Department maintained that consolidation on its timetable reduces rate shock and allows for planning to meet the increase in costs. The Department compared its approach to that taken by the Commission in a recent gas rate matter.<sup>287</sup>

223. CenterPoint responded by revising its proposal to a 50% adjustment to Viking area customers to take effect with the rate change in this proceeding and the remaining 50% adjustment to occur 12 months after the rate change takes effect.<sup>288</sup> The Department adjusted its proposal to have the merger adjustment occur in one step, 18 months after the rate increase takes effect (or April 2008, whichever is later). The Department reasoned that the Viking area merger increase should be timed to avoid the costs of the peak heating season.<sup>289</sup>

224. CenterPoint's proposal accomplishes the merger in a reasonable period of time, but Viking-area residential customers would see a big jump in rates over twelve

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<sup>284</sup> Ex. 70, Bonnett Direct, at 27.

<sup>285</sup> Ex. 12, Hammond Direct, at 22.

<sup>286</sup> Ex. 13, Hammond Rebuttal, at 21.

<sup>287</sup> Ex. 70, Bonnett Direct, at 28-30 (citing *In the Matter of a Petition by Great Plains Natural Gas Company, a Division of MDU Resources Group, Inc., for Authority to Increase Natural Gas Rates in Minnesota*, Docket No. G-004/GR-04-1487, PUC Order at 26-27 (Findings of Fact, Conclusions and Order issued May 1, 2006) ("**Great Plains**").

<sup>288</sup> Ex. 13, Hammond Rebuttal, at 21.

<sup>289</sup> Ex. 74 Bonnett Surrebuttal, at 12; Department Brief, at 98.

months. The Department's proposal recognizes the significant price increase arising from this matter and the likely additional increase that would occur if CenterPoint were to file for a rate increase again in two years. Positioning the price adjustment to the Viking area customers in between the two rate increases results in a lesser degree of rate shock, due to phasing in the increase between the two rate increases. The Department's proposal to implement the rate merger in one step after 18 months also provides a degree of certainty regarding these increases to Viking area customers. It is a reasonable approach.

### **Block Rate Design**

225. As part of its proposed rate design, CenterPoint proposed a change to the delivery rate from its current flat charge of \$0.09093 per therm. The new rate follows a modified inverted block rate approach. As proposed by CenterPoint, the delivery charge would be \$0.21000 per therm on the first unit of therms, up to 18 therms. The next 82 therms would be provided at the lower charge of \$0.12000 per therm. The next 150 therms would be provided at \$0.12500 per therm. All usage over 250 therms would be provided at a delivery rate of \$0.21000 per therm.<sup>290</sup>

226. CenterPoint maintained that the first block of therms would cover "primarily non-heating usage or the minimum base use each month during the year for this class."<sup>291</sup> CenterPoint's reasons for setting this level of pricing for this block were "better assuring that low usage customers cover the cost of service [and] . . . provid[ing] more certain recovery of a minimum level of costs incurred by the Company."<sup>292</sup>

227. The Department opposed CenterPoint's use of the initial block rate as an inappropriate method of recovering fixed costs. CenterPoint described its approach as resulting in "stable monthly revenue of nearly \$12 a month from each customer . . . a meaningful increase in the recovery of ongoing, fixed type costs through the rate design was obtained."<sup>293</sup> The Department also noted that the declining block rate discouraged conservation by providing lower rates until the 250 therm threshold was reached.<sup>294</sup>

228. The Department advocated retaining the flat rate approach per therm. In the alternative, the Department proposed an inverted block rate design which increases the price of gas as each threshold is reached to promote conservation. The first block would have the lowest price per therm, covering the first 100 therms. The price would increase for the second block of 150 therms. The third block would consist of all gas purchased over 250 therms and this block would have the highest price per therm. Assuming no changes to CenterPoint's requested revenue, the Department estimated

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<sup>290</sup> Ex. 1, Binder 1, Proposed Tariffs.

<sup>291</sup> CenterPoint Brief, at 124.

<sup>292</sup> CenterPoint Brief, at 124.

<sup>293</sup> Ex. 71, Bonnett Direct, JB-7, at 2.

<sup>294</sup> Department Brief, at 99-100.



that the block rates would be: \$0.13428 (first block), \$0.15604 (second block), and \$0.21000 (third block).<sup>295</sup>

229. The Department analyzed the percentage increase of costs to an average residential customer over a typical twelve-month cycle using CenterPoint's proposed block rates. In those months with low usage, staying in CenterPoint's first block (18 therms), the customer experiences an increase of 6.3% over the present rate. In the highest usage months, the average user experiences an increase between 2.5 to 2.7%.<sup>296</sup> The comparison is also useful for estimating the impact on low-volume consumers (using 18 therms or less in a month). The Department's comparison of costs indicates that such users will experience an increase of approximately 6.3% under CenterPoint's proposed block rate design.

230. CenterPoint's modified inverted block rate proposal is explicitly designed to increase the minimum monthly cost paid by residential customers. The Commission has expressed its opinion on such costs, and their impact on customers. There is no reason to impose a more complicated volumetric charge as a means of disguising what is, in effect, a higher monthly basic charge. The Department and OAG have shown that retaining the flat rate approach is more consistent with principles of rate design, particularly with regard to reducing customer confusion and minimizing rate shock. Following those principles, the Administrative Law Judge recommends retention of the flat rate volumetric charge for CenterPoint's rate design.

231. Should the Commission determine that an inverted block rate would create greater incentives for conservation and that those incentives outweigh other rate design considerations, the Department's inverted block system would better protect low volume customers from rate shock.

### **LGS Rate Design**

232. As part of its proposed rate design, CenterPoint requested a change in the Demand and Commodity rates for the LGS customer class.<sup>297</sup> The change was described as revenue neutral.<sup>298</sup> CenterPoint maintains that the current commodity component for rates in this class unduly limits the flexibility needed for negotiation to obtain customers for this class. There are currently no customers receiving service under this rate.

233. The Department questioned whether the LGS changes would create an incentive for a current customer (particularly at the LVDF rate) to change to the LGS rate at a lower cost, resulting in less revenue to CenterPoint. This situation could result in a subsidy to the LGS class.<sup>299</sup> CenterPoint adjusted its proposed change to have the

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<sup>295</sup> Ex. 71, Bonnett Direct, at 34.

<sup>296</sup> Ex. 71, Bonnett Direct, JB-8.

<sup>297</sup> As noted in a foregoing finding, CenterPoint is also proposing to increase the basic charge for this class by \$70.00.

<sup>298</sup> Ex. 12, Hammond Direct, at 25.

<sup>299</sup> Ex. 71, Bonnett Direct, at 36.

LGS commodity rate mirror the LVDF class delivery charge. The result was to minimize the difference in price between the LGS and LVDF classes.<sup>300</sup> The Department agreed that CenterPoint's modified approach addressed the potential for a revenue deficiency and recommended that the LGS rate design be approved as finally proposed.<sup>301</sup>

## **O. Customer Billing System Implementation**

234. Beginning in Summer 2005, CenterPoint began notifying customers through its bill inserts and website that a new billing system was planned.<sup>302</sup> The CCS system was originally scheduled for launch in September 2005, but was delayed to January 2006.<sup>303</sup>

235. CenterPoint's 2005 performance goals for call center contact included answering 75% of telephone calls within 30 seconds, answering calls at an average speed ranging from 22 to 28 seconds, and having an abandoned call percentage that does not exceed the range of 5 to 8%. In 2005, CenterPoint answered 78% of the calls within 30 seconds, at an average speed of 23 seconds, and with 7.9% of the calls abandoned.<sup>304</sup>

236. CenterPoint expected an initial decline in customer service performance following implementation, due to increased call volume and longer call handling time. For those reasons, CenterPoint asserted that preparations for the new system conversion included staffing CenterPoint's call center with customer service representatives ("CSRs") at a higher than normal level entering Fall 2005.<sup>305</sup>

237. CenterPoint introduced its CCS in January 2006. At that time, the address for customer payments changed from Minneapolis, Minnesota to Houston, Texas. CenterPoint was aware that the U.S. Postal Service standard for mail delivery was two days longer for the new mailing address. CenterPoint did not emphasize the impact of the change in the information made available to customers.<sup>306</sup>

238. The OAG disputed CenterPoint's claims regarding adequate staffing, noting that CenterPoint's available CSRs declined by 16 from the period the system was expected to enter service compared to when the CCS was actually initiated.<sup>307</sup> Further, the OAG notes that CenterPoint planned for insufficient trunk line capacity, resulting in customers receiving busy signals. Many of those calls were abandoned by customers before a CSR was available to respond to the customer inquiry.

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<sup>300</sup> Ex. 13, Hammond Rebuttal at 16-19.

<sup>301</sup> Department Brief, at 103.

<sup>302</sup> Ex. 110.

<sup>303</sup> Ex. 97, Pyles Supplemental, at 7-8; Ex. 98, Newman Supplemental, at 4-5, Ex. 108, Ex. 146; and Hearing Tr. Vol. 4, at 24-25 (Newman).

<sup>304</sup> Ex. 98, Newman Supplemental, at 3

<sup>305</sup> Ex. 98, Newman Supplemental, at 4-5, Ex. 108, and Hearing Tr. Vol. 4, at 24-25 (Newman).

<sup>306</sup> Hearing Tr., Vol. IV, at 55.

<sup>307</sup> OAG Brief, at 69-70.

239. Complaints were received and the Commission's Consumer Affairs staff discussed the situation with CenterPoint on February 16, 2006.<sup>308</sup> CenterPoint began providing weekly status reporting to the Commission on call center volumes and CSR response time. The volume of calls was significantly above the normal level of customer inquiry. The average answering speed was just under four minutes for the week of January 23, 2006. Abandoned calls accounted for 20.6% of calls received. Only 17% of the calls were answered within 30 seconds.<sup>309</sup>

240. Over the following weeks, call center volume declined, additional telephone trunk lines were added (increasing capacity by 15%), and CSR familiarity with the new system increased. CenterPoint noted that the primary areas for customer questions were billing inquiries (about the format, no previous balance, did not receive bill), budget billing questions, payment issues (not showing payment that was made, issues with automatic withdrawal), and high gas bill questions.<sup>310</sup>

241. As CenterPoint completed its addition of trained staff and additional telephone capacity, call center volume increased to over 3,000 calls per day, with the average answering time falling from 117 seconds in the week ending March 3 to 80 seconds in the following week. Abandoned calls fell to 14.5%. CenterPoint noted that many of the customer inquiries were being handled through the website customer service application or through interactive voice response (IVR, another automated system using structured questions and simple answers to access information).<sup>311</sup>

242. The March 2006 call volume, average speed of answer, and abandoned call percentage remained constant. The most significant improvement came with the week ending March 10, which had 37% of calls answered within seconds, but that figure fell to 27% the following week, partly caused by inclement weather.<sup>312</sup> The April call volume declined to consistently below 3,000 calls per day, but the average answering speed remained at just under one minute. At no point did CenterPoint answer half of the calls within 30 seconds (compared with the 2005 goal of 75%).<sup>313</sup>

243. CenterPoint responded to the staffing issue, indicating that each CSR requires, on average, 400 hours of training. This training includes 276 functionality sets and 1,296 scenarios, covering all types of customer service inquiries.<sup>314</sup> CenterPoint maintains that this investment in time, and the burden on available training resources, prevented any additional CSRs from being available to handle the volume of calls.

244. CenterPoint considered a multi-tiered system, where customer calls are triaged for appropriate handling. CenterPoint described the intake layer as "untrained

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<sup>308</sup> Ex. 98, Newman Supplemental, at 5.

<sup>309</sup> Ex. 98, Newman Supplemental, at 5, Status Reports to MPUC.

<sup>310</sup> Ex. 98, Newman Supplemental, Status Reports to MPUC, Weeks of 2/20 and 1/23.

<sup>311</sup> Ex. 98, Newman Supplemental, Status Reports to MPUC, Weeks beginning March 6.

<sup>312</sup> Ex. 98, Newman Supplemental, Status Reports to MPUC, Weeks beginning March 13.

<sup>313</sup> Ex. 98, Newman Supplemental, Status Reports to MPUC, Weeks beginning March 27, April 10, and April 17.

<sup>314</sup> Ex. 98, Newman Supplemental, at 7; Ex. 97, Pyles Supplemental, at 15-16.

employees.”<sup>315</sup> This approach was considered to be “not a viable strategy because it creates a cycle of repeat customer call backs and excessive backlog.”<sup>316</sup> CenterPoint has not indicated how an unanswered call is superior to a system that actually answers customer calls, but may require a referral or a returned call.

245. CenterPoint was fully aware that an unusual event directly affecting customers would occur and when that event would occur. CenterPoint was also aware that more customers would be calling for assistance and that staff was needed to respond. CenterPoint was also aware that customers would have specific questions regarding the new billing system that could be answered by staff who were not fully-trained CSRs.

246. Adhering to full training schedules for CSRs to address a short-term information problem does not constitute reasonably prudent implementation of CenterPoint’s billing system. Failing to emphasize that the change in the billing address would add additional days to delivery was not reasonably prudent implementation of the new billing system.

247. CenterPoint responded to the customer billing problems arising from the billing changes by reversing late fees for those customers who payment was received up to five days after the due date. These reversed charges amounted to \$224,231, between February 2006 to May 2006. This amount is in addition to the late fees that were reversed when customers got through to CSRs and complained about the late fee. CenterPoint’s calculation of the total late fees reversed arising from customer service problems and the implementation of the billing system is \$300,378.<sup>317</sup> CenterPoint does not have any means of identifying customers who attempted to contact a CSR and were sufficiently frustrated to abandon further efforts.<sup>318</sup>

248. The Department maintained that CenterPoint’s reversal of late fees was insufficient and proposed that all late fees from February through June, 2006 be reversed.<sup>319</sup>

249. With the combined impact of a changed billing address and insufficient customer service response capacity, reversing late fees is an appropriate response. CenterPoint’s reversal of late fees for customers who were able to contact a CSR is appropriate, but the five-day grace period is insufficient to address the problem created by CenterPoint’s implementation problems. Customers have a reasonable expectation of being able to contact a utility before paying a bill that the customer does not understand. Since CenterPoint cannot identify individual customers who became discouraged, reversing late fees for payments received up to 30 days late over the period of February 2006 through June 2006 would more effectively address the problem. The continued high volume of customer calls strongly suggests that

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<sup>315</sup> Ex. 98, Newman Supplemental, at 5.

<sup>316</sup> Ex. 98, Newman Supplemental, at 5.

<sup>317</sup> Ex. 164.

<sup>318</sup> Hearing Tr., Vol. IV, at 47-48.

<sup>319</sup> Department Reply Brief, at 34.

customers are still raising questions about their bills. The 30-day period is more likely to reach the customers who had questions about CenterPoint's billing that were not answered promptly.

#### **O. Concepts to Govern**

250. The parties to this proceeding have taken significantly different approaches to how the revenues and expenses of CenterPoint should be calculated to arrive at just and reasonable rates. In a number of areas, the underlying cost numbers are not readily apparent from the record, resulting in an inability to set out detailed calculation of the precise numbers recommended by the Administrative Law Judge. The concepts set forth in these Findings and Conclusions should govern the mathematical and computational aspects of the Findings and Conclusions. Any computations found to be in conflict with the concepts expressed should be adjusted to conform to the concepts expressed in the body of this Report

Based on the foregoing Findings, the Administrative Law judge makes the following:

### **CONCLUSIONS**

1. The Minnesota Public Utilities Commission and the Administrative Law Judge have jurisdiction over the subject matter of this proceeding pursuant to Minn. Stat. Ch. 216B and section 14.50.

2. Any of the foregoing Findings which contain material which should be treated as a Conclusion is hereby adopted as a Conclusion.

3. CenterPoint has not demonstrated that its proposed capital structure reflects the actual financial transactions of the business. The Department's proposed capital structure of 44.31% long-term debt, 12.22% short-term debt, and 43.47% common stock equity. Should the Commission conclude that CenterPoint should be given the opportunity to provide further evidence regarding its capital structure, CenterPoint should be required to file a report by March 1, 2007 report consistent with the Department's recommendation and be ordered to true-up its adjusted revenue requirement as demonstrated by that report.

4. CenterPoint has not demonstrated that its proposed return on equity (ROE) strikes an appropriate balance between the interests of shareholders and ratepayers. The Department has demonstrated that its proposed ROE, 9.71%, does strike that balance and should be adopted in this matter.

5. With adoption of the Department's proposed capital structure, the allowable rate of return (ROR) is 7.42%. Should the Commission adopt CenterPoint's proposed capital structure, the ROR is 7.7%.

6. Use of the year ending on December 31, 2006 as the projected test year for determining CenterPoint's revenue requirement is reasonable. The Department

forecast of the total volume of CenterPoint's natural gas sales, using a twenty-year methodology, as 157,963,000 Dkt in the test year is reasonable. There is insufficient evidence in the record to address whether the 10-year average forecast methodology is superior to the 20-year average methodology. Use of the Department's forecast requires an increase in the cost of gas of \$1,469,040 and an increase in operating revenue of \$1,717,070. These changes result in a net required revenue reduction of \$248,030.

7. CenterPoint has demonstrated that it incurred the expenses for the Midwest Gas Replacement Project pursuant to a natural gas safety program within the meaning of Minn. Stat. § 216B.16, subd. 11. Under that statute, CenterPoint is entitled to recover the costs of the Project.

8. CenterPoint proposed that its projected test year rate base for the 12 month period ending December 31, 2006 be set at \$626,844,000. CenterPoint's forecast is appropriately adjusted for the actual 2005 ending plant balance. CenterPoint properly included \$39,536,861 as actual 2005 and projected 2006 tangible capital expenditures for the Midwest Gas Replacement Project and \$1,991,000 for capitalized inspection and clerical expenses arising from that Project. CenterPoint's test year net plant is appropriately reduced for the retirement of cash remittal equipment by \$274,403 (and the income statement expenses should be reduced by approximately \$66,000 for the change in processing from Minneapolis to Houston). CenterPoint's Customer Care and Service billing system brought into service in 2006 is properly included in the rate base with the half year convention for the total cost \$14.4 million for that system. Also, CenterPoint's rate base is appropriately revised downward by \$89,807 for errors in the application of service line extension tariffs.

9. The tariff changes agreed to by the parties are reasonable and should be adopted. CenterPoint should be required to continue reporting its winter construction and follow the Department's specific proposals for additional tariff language and reporting.

10. CenterPoint withdrew its request for unrecovered costs for rate case expenses from the **2004 Rate Matter**, estimated at \$554,167. CenterPoint's request for \$1,182,275 for rate case expenses in this matter is appropriate, reduced by CenterPoint's general allocator for nonregulated business operations, and the resulting total amortized over a four-year period.

11. CenterPoint's CIP tracker proposal should be approved, offsetting the CIP tracker account balance against any interim rate refund required in this matter. Any remaining balance should be amortized over a four-year period. CIP costs should be allocated among rate classes on a volumetric basis.

12. The Department's recommendation to use the interest synchronization method for income tax purposes is appropriate and thereby increases CenterPoint's tax expense by \$344,000.

13. CenterPoint's proposed corporate expenses should be reduced by the test year general allocation factor determined by the Department, resulting in an adjustment of \$368,767 to those expenses. An additional adjustment of \$186,132 for improperly allocated legal expenses is appropriate. CenterPoint did not meet its burden to demonstrate the reasonableness of its claimed expenses allocated from its parent corporation, CNP. The claimed amount should be reduced by \$2,080,683 in accordance with the Department's analysis of those corporate expenses.

14. CenterPoint's test-year general and administrative expense should be reduced by \$220,797 to adjust the pension expense using the levelizing methodology proposed by the Department.

15. CenterPoint and Energy CENTS have demonstrated that calculation of the test-year bad debt expense as 1.27% of the test year firm revenue is reasonable. The proposal (now withdrawn) to recover the gas cost portion of the bad debt expense through the PGA is contrary to law and could not have been approved.

16. CenterPoint's "fleet adjustment" to reflect an increase in miles driven and the increase in the per-gallon cost of gasoline between the base year and the test year is appropriate and should be included in the test year expenses.

17. The Department's proposal to use a four-year average of actual claims activity attributable to regulated operations to determine the allowable claims expense is appropriate. CenterPoint's proposal to use the actual claims activity through December 2005 is reasonable and the claims expense average should be calculated using that data.

18. CenterPoint's claimed expenses of \$1,047,794 for general and informational advertisements were disputed by the Department as not meeting the statutory requirements for allowable expenses. The parties agreed that the claimed expenses should be reduced by \$7,568 to account for the disputed expenses. At the evidentiary hearing, CenterPoint agreed to that adjustment.<sup>320</sup> The effect of the change is to decrease the allowable advertising expense by \$7,568 to \$1,040,236.

19. CenterPoint's proposed \$250,000 expenses for GTI research and development, agreed to by the parties are reasonable costs for inclusion in the test year. The Commission should direct CenterPoint to establish a separate liability account for these expenses, with a starting balance equal to all revenues collected from ratepayers for GTI project funding from the implementation of interim rates in this ratemaking. Annual expenses for research and development should not to be carried over from year-to-year. The Commission should require CenterPoint to submit annual compliance filings on this account, detailing revenues and GTI expenses over the prior period.

20. The Affordability Program, as agreed to between CenterPoint and Energy CENTS, with an annual budget of \$5 million charged solely to the residential class of

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<sup>320</sup> Hearing Tr. Vol. 2, at 152.

ratepayers is reasonable. There is no impropriety in determining eligibility for the program by requiring actual receipt of LIHEAP benefits. The division of the assistance into an affordability component and an arrearage forgiveness component is reasonable.

21. CenterPoint and the Department have not demonstrated that an increase in the residential basic charge to \$8.00 per month is an appropriate adjustment to balance the need to recoup the costs of serving the residential class of customers with the need to encourage conservation, avoid rate shock, and account for other factors between rate classes.

22. There is sufficient evidence in the record to support an increase in the residential basic customer charge from \$6.50 per month to \$7.00 per month, while avoiding rate shock and meeting the Commission's obligation to encourage energy conservation.

23. CenterPoint has not demonstrated that a modified inverted block rate is appropriate for the residential customer class. The Department has not demonstrated that implementing an inverted block rate is needed to encourage conservation in the residential customer class.

24. CenterPoint has not demonstrated that its proposed allocation of the rate increase across customer classes is sufficiently sensitive to the principle of rate shock. With the recent rate impact of the **2004 CenterPoint Rate Matter**, CenterPoint's proposed allocation overemphasizes the need to eliminate cross-subsidization between customer classes. Since the residential class of customers cannot pass on price increases and that class of customers is already experiencing the impact of increasing wholesales gas prices, apportioning a higher percentage of the rate increase in this matter to the residential class is unreasonable. The Department's proposed revenue apportionment, 2.69% across all customer classes that are not experiencing competition, strikes the best balance between the various rate design principles of the Commission. The Department's proposal must be modified to allocate the approved cost of the Affordability Program solely to the residential class.

25. The merger adjustment between the Northern area and Viking area should occur in one step, 18 months after the rate increase in this matter takes effect (or April 2008, whichever is later).

26. CenterPoint has demonstrated that its investment in a new billing system was prudent. CenterPoint has not demonstrated that its implementation of the new billing system and related calling issues was prudent. The Commission should order that CenterPoint reverse its late fees for customer payments received up to 30 days late over the period of February 2006 through June 2006 to address the shortcomings in the implementation of those systems.

27. Modifying CenterPoint's natural gas rates in the manner described in the Findings and Conclusions above results in just and reasonable rates that are in the public interest within the meaning of Minn. Stat. § 216B.11.



28. The rate finally ordered by the Commission should be compared to the interim rate set in the Commission's December 21, 2005 Order, and a refund be ordered to the extent that the interim rate exceeds the final rate, subject to any true-up ordered regarding any particular expense.

Based on the foregoing Findings and Conclusions above, **IT IS RECOMMENDED** that the Public Utilities Commission issue the following:

### **ORDER**

1. CenterPoint is entitled to increase gross annual revenues in the manner and in an amount consistent with the terms of this Order.

2. Within 30 days of the service date of this Order, the CenterPoint shall file with the Commission for its review and approval, and serve on all parties in this proceeding, revised schedules of rates and charges reflecting the revenue requirement for annual periods beginning with the effective date of the new rates, and the rate design decisions contained herein. CenterPoint shall include proposed customer notices explaining the final rates. Parties shall have 14 days to comment.

3. (If the Commission orders an Interim Rate Refund) within 30 days of the service date of this Order, CenterPoint shall file with the Commission for its review and approval, and serve upon all parties in this proceeding, a proposed plan for refunding to all customers, with interest, the revenue collected during the Interim Rate period in excess of the amount authorized herein. Parties shall have 14 days to comment.

Dated this 8<sup>th</sup> day of September, 2006.

/s/ Beverly Jones Heydinger  
BEVERLY JONES HEYDINGER  
Administrative Law Judge

Reported: Shaddix and Associates  
Transcripts Prepared